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AMERICAN
LAW AND PROCEDURE

VOLUMES I TO XII PREPARED UNDER THE
EDITORIAL SUPERVISION OF

JAMES PARKER HALL, A.B., LL.B.
Dean of Law School, University of Chicago

AND

VOLUMES XIII AND XIV BY

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AMERICAN LAW AND PROCEDURE

VOLUME VII.

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NEGOTIABLE INSTRUMENTS

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BANKS, BANKING, AND TRUST COMPANIES

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CHAPTER I.

NEGOTIABILITY.

§ 1. Genesis of law of bills and notes in mercantile usage. The first case involving the law of bills and notes, which appears in the English law reports, was decided in 1603 (1). Doubtless there were earlier cases which came before the common law courts, but these must have been few, otherwise all of them would not have escaped the reporter. At the same time, we know that bills of exchange had been in use in England for at least a century and probably much longer, and on the continent of Europe from a still earlier time (2). Now such instruments could not have been effectively used in business, without a body

(1) Martin v. Boure, Cro. Jac. 6. See opinion of Chief Justice Cockburn in Goodwin v. Robarts, L. R. 10 Exchequer 337.

(2) See opinion of Cockburn, C. J., cited above.

of rules, however general and incomplete, defining the relations to one another and to third persons of the parties to them, and this would lead us to suppose that there must have been such a body of rules, worked out by some one and in some way, which was usually observed by persons dealing with bills. In fact, this was the case. The merchants, whose needs had called into existence the bill and the note, evolved, by their habitual mode of dealing with them, a commercial custom which established the rights and duties of parties to that kind of commercial contract.

§ 2. **Decisions of courts adopt mercantile usage into common law.** In how great detail mercantile usage had provided rules, how far the mercantile usage of England differed from that on the Continent, and how the observance of these rules was enforced before resort was had to the common law courts, are questions which do not concern us. But it is clear, that, when the common law courts were first called upon to decide cases arising upon bills and notes, they found these customary rules, more or less completely covering the questions presented, ready to be adopted in toto by them as a rule of decision, or to be applied in a modified form, or, if the courts saw fit, to be rejected. The courts did, for the most part, adopt the mercantile usage as a basis for their decisions; thereby transforming, precept by precept, what hitherto had been mere usage into positive law. Thus, the so-called "custom of merchants" or the law merchant, relating to bills and notes, became part of the common law.

§ 3. **Bills and notes are transferable obligations.** It is not surprising, therefore, to find that the part of the law

dealing with bills and notes is based upon conceptions quite antagonistic to the ordinary working principles of the common law. One of these is the conception of a bill of exchange or a promissory note as a kind of property which may be transferred by its owner to another. The quality of transferability is one of the qualities described when we say that bills and notes are negotiable. But are not all kinds of property transferable? Let us see. A may transfer his horse to B by a voluntary act of delivery, coupled with an intention to make B the owner. A may transfer his land, or an interest therein, by the intentional delivery of a deed, evidencing the transfer to B. But suppose X is indebted to A on a promise, either oral or in writing, to pay A $100, and A wishes to transfer the obligation to B, may he do so? This question was answered originally by the common law and the equity courts in the negative (3). A *debt*, or a *chose in action*, was not transferable property. There was no way in which A could divest himself of his right against X, except of course by the release of X, which results in the extinguishment of the right itself. Now consider the case where X is indebted to A on his promise contained in a promissory note or bill of exchange. Is the obligation of X transferable? If it is a common law debt, it is not transferable, as we have just seen. But it is not that. It is a mercantile obligation, originally deriving its force and effect from mercantile usage, and by that usage it was transferable (4). Thus,

(3) Sheppard's Touchstone, 240; Hammond v. Messenger, 9 Simon, 327. For the present law regarding assignment of ordinary contracts see Contracts, §§ 101-14, in Volume II of this work.

(4) Miller v. Race, 1 Burrow, 452.

after the recognition of the law merchant by the common law, we find two kinds of legal obligations: the one, the untransferable, unassignable, common law debt; and the other, the obligation embodied in the bill of exchange or promissory note, which has the quality of transferability as completely as horses, or other tangible personal property, or land.

§ 4. **Practical consequences of bills and notes being transferable.** The quality of transferability is of the greatest practical consequence, and is one of the peculiarities which makes bills and notes of value as instruments of trade and of credit. If X buys land of A, giving A his note for $1000 in payment, and it transpires that A did not have the title so that X gets nothing, the failure of the consideration for which the note was given gives X a perfect defence against A's action on the note, because it would be unjust to allow A to enforce it. Suppose, however, A had sold the note to B, who had bought it in good faith, has X the same defence against B that he had against A? What was X's defence against A? Not that there was no note, for the intentional execution of the note by X is admitted, but that it was *unjust* for A to enforce the obligation. Certainly this objection cannot be raised to B's recovery. He owns the obligation of X, and, since he purchased it without notice of X's defence against A, there is no reason in law or in morals why B may not enforce the right against X he has lawfully acquired.

§ 5. **Same: Illustrations.** If X, instead of giving his note for the land, had made a simple promise to A to pay

for it, the result would be different. Of course X has his defence against A, but, if A attempts to sell his right against X to B, who has no notice of X's defence, what are B's rights? We have seen that a common law obligation is not transferable. Clearly then the attempted transfer vests in B no rights against X. Notwithstanding the sale, X's obligation to pay still runs to A. The only effect of the attempted transfer was to make B A's agent to collect the money, or to bring an action in A's name as plaintiff against X (5). Since the obligation is still A's and its enforcement is by him as plaintiff, X's defence, that it is unjust for A to proceed against him, continues available, notwithstanding the attempted transfer, the only practical consequences of which were to give B the right to use A's name, and to keep the proceeds of the debt, if any were realized (6).

That the difference between B's positions, in the two cases just discussed, depends upon the fact that the note is transferable or negotiable property, and that the common law debt is not, is made more clear by a case where X is induced, by fraud and deceit of A, to sell A his horse or his land, and thereafter A resells the property to B, who buys in good faith. Horses and land are transferable property, and the intentional transfer of X made A the owner of the property transferred. Since he has become owner through the fraud practiced on X, the courts com-

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(5) Almost everywhere today B might bring action in his own name as plaintiff. This result is obtained by statutes, which, although they change the procedure, do not clash with the rule stated in the text that choses in action are not transferable.

(6) Barrow v. Bispham, 11 N. J. L. 110.

pel him on obvious grounds of justice to return the property. But, if B has innocently purchased the property from A and thereby become the owner, there would be no justice in depriving B of his rights of ownership, and he is allowed to keep the property. The same result is reached in this case as in the case of the bill or note, for the reason that in both cases we are dealing with transferable property (7).

§ 6. **How bills and notes may be transferred.** Bills and notes are unique, then, in that they represent obligations to pay money which are as transferable as goods or land. They possess, however, another quality quite as peculiar as that of transferability, which determines the manner in which they may be transferred. The usual mode of transferring title to goods is by a voluntary delivery, i. e., voluntary actual transfer of the goods, coupled with an intention to make the transferee the owner. The common mode of transferring land is by a voluntary delivery of a deed, with an intention to vest title in the grantee. A mere delivery or an involuntary change in the actual possession of the goods or of the deed, without an intention to pass title, would be ineffective. For example, A, with force and without X's consent, takes X's horse out of his possession—steals it. The physical act of taking possession is just as complete as if X had given his consent to it, but A does not become the owner because the necessary element of intention is absent (8). The same would be true if A stole from X a deed reciting a transfer of

(7) Rowley v. Bigelow, 12 Pick. (Mass.) 306.

(8) Dame v. Baldwin, 8 Mass. 518.

the land to A. But the obligation embodied in a bill or note differs quite as completely in the manner of its transfer, from other kinds of transferable property as it does from the ordinary common law debt or obligation to pay money, in being transferable at all. A bill or note, if payable to bearer, or indorsed in blank, is transferable by a mere transfer of the instrument, whether voluntary or involuntary, intentional or unintentional (9). Thus, if X owned such a note and A stole it from X, the title to the note would vest in A. Of course A would not be allowed to enforce the obligation, and would be compelled to return the note to X, but this is because of the manifest injustice of allowing him to keep it or assert his right upon it, not because he has not become the owner. In consequence, if A, the thief, sells the note to B, who knows nothing of the theft, B, having become the owner for value and without notice, may exercise the rights of ownership he has acquired from A, by holding and collecting it, or further negotiating it (10). Contrast this with a case where A steals X's horse, and then sells the horse to B, who is innocent of the theft. Here B, notwithstanding his innocence and the fact that he paid a full price to A, has no rights whatever in the horse. The reason is obvious: A by the theft of the horse did not become the owner; and the transfer of possession from X to A was involuntary and not coupled with an intention on X's part to make A owner. The horse never

(9) This is not true of bills and notes payable to order, unless they are indorsed. See § 83, below.

(10) Miller v. Race, 1 Burrow, 452; Grant v. Vaughn, 3 Burrow, 1516; Peacock v. Rhodes, 2 Douglas, 633.

became the property of A, and B could not become the owner by a transfer from A to whom the property did not belong (11).

§ 7. **Summary: Bills and notes are negotiable.** Bills of exchange and promissory notes, then, differ from common law obligations to pay money, in that bills and notes are transferable. They differ from other kinds of transferable property, as goods and land, in that they are transferable by mere delivery or even by involuntary change of possession. These two qualities are what give bills and notes the name of *negotiable* instruments. In their character as negotiable instruments they are like money, and it is their similarity to money which makes them of so much practical value in the business world.

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(11) Dame v. Baldwin, 8 Mass. 518.

CHAPTER II.

FORMAL REQUISITES OF NEGOTIABLE INSTRUMENTS.

§ 8. **In general.** So far, we have spoken only of bills of exchange and promissory notes as negotiable instruments. But all bills and notes are not negotiable, and there are other mercantile instruments which are. What are the standards up to which an instrument must measure to be negotiable? The Negotiable Instrument Law (1) states generally the requisites as to form as follows:

(1) "The Negotiable Instruments Law" is a statute which was prepared by the Commissioners on Uniform State Laws to codify and make uniform the law of negotiable instruments throughout the United States. For the most part it codifies the pre-existing law. It has been adopted without important amendment in the District of Columbia and thirty-five states and territories. For these two reasons it is cited and discussed in this article as an authoritative statement of the law of Negotiable Instruments. The following is a list of the jurisdictions which have adopted it (1909):

Alabama (1907)	Louisiana (1904)	North Dakota (1899)
Arizona (1901)	Maryland (1898)	Ohio (1902)
Colorado (1897)	Massachusetts (1898)	Oregon (1899)
Connecticut (1897)	Michigan (1905)	Pennsylvania (1901)
District of Columbia (1899)	Missouri (1905)	Rhode Island (1899)
Florida (1897)	Montana (1903)	Tennessee (1899)
Hawaii (1907)	Nebraska (1905)	Utah (1899)
Idaho (1903)	New Jersey (1902)	Virginia (1897-8)
Illinois (1907)	Nevada (1907)	Washington (1899)
Iowa (1902)	New Mexico (1907)	West Virginia (1907)
Kansas (1905)	New York (1897)	Wisconsin (1899)
Kentucky (1904)	North Carolina (1899)	Wyoming (1905)

The law of England was similarly codified in 1882 by the Bills of Exchange Act, the provisions of which are largely incorporated into the American act.

Sec. 1. An instrument to be negotiable must conform to the following requirements:

1. It must be in writing and signed by the maker or drawer.

2. Must contain an unconditional promise or order to pay a sum certain in money;

3. Must be payable on demand, or at a fixed or determinable future time;

4. Must be payable to order or to bearer; and

5. Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty.

§ 8a. Ordinary forms of negotiable instruments. The typical form of a promissory note is this:

"Chicago, December, 20, 1909.

Three months after date I promise to pay to John Jones, or order [*or*, to the order of John Jones], four hundred dollars [with interest *may be added if desired*].

Jacob Smith."

The typical form of a bill of exchange is:

"Chicago, December 20, 1909.

Pay to the order of John Jones four hundred dollars

Richard Flint.

To Jacob Smith,
16 John St.,
New York City.

Accepted,
Jacob Smith."

A check is like a bill, except that is it directed to a bank or banker, and is not accepted.

In the note, above, Jacob Smith is maker and John Jones is payee. In the bill, Richard Flint is drawer, Jacob Smith is drawee and acceptor, and John Jones is payee. In a check a bank is drawee, and there is no acceptor. The drawer and payee are as in the bill.

§ 9. **Materials for writing. Signature.** A negotiable instrument may be written upon any substance capable of receiving writing. Paper is naturally the substance of greatest convenience and most common use, but there would seem to be no legal objection to more or less easily destructible material, as glass, on the one hand, or wood, metal, or stone on the other. Since, however, the custom of merchants is what originally gave this kind of written contract its negotiable qualities, it might well be argued that any substance which is not legitimatized by mercantile usage and would deprive the instrument of value in business, would deprive it of its character as "commercial paper." This question, however, is largely academic, for it is unlikely that any one will attempt to inscribe a promissory note on a tombstone (2).

The writing may be executed by any instrument or tool sufficient for the purpose. Pen and ink are of course ordinarily used, but a writing in pencil is permissible, although not advisable (3). An instrument, every part of which, including the signature, is typewritten, or is printed (4), or one on which the signature is stamped (5), is per-

(2) See Daniel on Negotiable Instruments, sec. 77.
(3) Geary v. Physic, 5 Barnwell & C. 234.
(4) Weston v. Myers, 33 Ill. 424.
(5) Mayers v. McRimmon, 140 N. C. 640.

fectly valid. The practical disadvantage of typewritten and penciled instruments and signatures is their easy obliteration and alteration. Printed and stamped signatures, while not open to this objection, are more difficult to prove than a signature in the handwriting of the signer.

§ 10. **Note must contain a promise.** The ordinary form of promissory note reads "I promise to pay," etc. and thus complies in express terms with this requirement. But such formal accuracy is not necessary; any words of equivalent import are sufficient. Thus the following document was held a promissory note:

"NATHANIEL O. WINSLOW, Cr.
By labor 16¾ days at $4 per day, $67.00
Good to bearer. (Sgd) Wm. Vannah."

The words "Good to bearer" impute a promise as clearly as "I promise to pay to bearer" (6).

But the following instruments, "I owe my father 470 pounds" (7); "Due Currier and Barker, $17.14" (8); and "I. O. U., E. A. Gay, the sum of $17 5/100 for value received" (9); were held not to be promissory notes. The reason is that they were simply admissions or acknowledgment of indebtedness. Now admitting the existence of a debt is a very different thing from a promise to pay it; therefore, it can not be said that a written admission imports a promise. It is true in the first case, for example, if the admission were true, that the father could

(6) Hussey v. Winslow, 59 Me. 170.
(7) Israel v. Israel, 1 Campbell, 499.
(8) Currier v. Lockwood, 40 Conn. 349.
(9) Gay v. Rooke, 151 Mass. 115.

recover the 470 pounds from his son, but this is because he owed the debt, and not because he had promised to pay it.

§ 11. **Same (continued).** A written acknowledgment of a debt, however, may be coupled with other expressions from which a promise to pay the debt acknowledged may be spelled out. The following time check is a promissory note (10):

"Time Check, No. 189. $98.65. General Managers' Office, Hawkeye Gold Mining Co. Pluma, So. Dak., June 10, 1893. Due W. C. Robinson the sum of ninety-eight dollars and sixty-five cents ($98.65), payable at this office, on the 20th day of June, 1893, to him or order. David Hunter, General Manager, by L. A. Fell. W. C. Robinson."

And so is an instrument in this form: "Due John Allen, $94.91 on demand" (11). The reasoning upon which these decisions is based, and upon which they are distinguished from the case of a bare admission of a debt, is that the words "payable at this office on the 20th day of June" in the former, and "on demand" in the latter, indicate an intention to pay the debt at the time specified. "I. O. U. $20 payable tomorrow," or "Due A $20 to be paid on demand," or even "Due A $20, on demand," are susceptible of the construction "Due A $20, which I promise to pay tomorrow," or "on demand."

Upon the same principle certificates of deposit issued

(10) Schmitz v. Mining Co., 8 So. D. 544.
(11) Smith v. Allen, 5 Day 337 (Conn.).

by banks may be promissory notes. This was held by the United States Supreme Court when the following certificate was before it (12):

"No. 959, Mississippi Union Bank.

Jackson, (Miss.) Feb. 8, 1840. I hereby certify that Hugh Short has deposited in this bank, payable twelve months from 1st May, 1839, with 5 per cent. interest till due, fifteen hundred dollars, for the use of Henry Miller, and payable only to his order upon the return of this certificate, $1,500.

William P. Grayson, Cashier."

§ 12. **Bill of exchange must contain an order.** This requirement is also expressly met in the regular form of bill or draft, which in imperative terms directs the person upon whom the bill is drawn to "Pay to A" the sum specified. But the language employed is not always unambiguous, and it sometimes is difficult to determine whether the instrument is simply a request to pay, or a mere authority to collect money due, either of which is the antithesis of an order or imperative direction, i. e., a direction which implies in its terms a right to command and a duty to obey.

"Dear Sir.—We hereby authorize you to pay on our account to the order of W. G., etc." is not a bill but a mere authorization to the debtor to pay W. G. and constitutes him agent to collect (13). "Please to send 10 pounds by bearer, as I am so ill I cannot wait on you" (14) is clearly

(12) Miller v. Austin, 13 Howard, 218.
(13) Hamilton v. Spottiswoode, 4 Exchequer, 200.
(14) King v. Ellor, 1 Leach Crown Law, 323.

simply a request and therefore not a bill. But words of politeness do not deprive an order of its imperative quality. Thus, "Please pay A" is a common phrase in bills, and even the following has been held a bill of exchange: "Mr. Nelson will much oblige Mr. Webb by paying J. Ruff, or order, 20 guineas on his account" (15). Judged by these tests there is no doubt that the following statement of account and memorandum, delivered by a contractor to his subcontractor to enable the latter to collect his account from the owner, who was indebted to the contractor, was properly held to be a bill (16):

"New York, 16th Dec., 1847.

Messrs. Smith and Woglom,

To C. H. Hoyt, Dr.

To tin roof, 86 ft. x 37½ ft. 3225 ft. at 7½c.	$241.87
112 of 3 in. leader	11.20
85 ft. of copper gutter, 4s 6d	47.81
	$300.88

Williamsburg, Dec. 16, 1847.

Mr. J. Lynch:

Please pay the above bill, being the amount for tinning your houses on South Sixth St., and charge the same to our account,

And much oblige yours,
Smith & Woglom."

(15) Ruff v. Webb, 1 Espinasse, 129.

(16) Hoyt v. Lynch, 2 Sanf. Sup. Ct. 328.

§ 13. Promise or order must be unconditional. An instrument which carries on its face an obligation, upon which the money will not be payable unless some specified event happens, would be of little value in business before the condition happened, because it might never happen, and even after the happening of the condition, the fact the promise had thus become absolute would not be disclosed on the paper. In consequence, although such an instrument witnesses a perfectly valid contract, it is not one which the custom of merchants clothed with the quality of negotiability.

For example, Coleman gave Blake a paper, on which was written the ordinary form of a promissory note signed by Coleman, but on the back was written: "L. S. Blake, or bearer is not to ask or expect payment of said note until his, Coleman's old mill is sold for a fair price." This indorsement turned what otherwise would have been a promissory note into a common law contract (17). For the same reason, the following order, which made a condition of its payment the production of the bank book, was held not a bill of exchange (18):

"Dover, Oct. 27, 1893.

$120.

Piscataquis Savings Bank.

Pay James Lawler, or order, one hundred and twenty dollars, and charge to my account on book No. —

Witness ———— J. N. Cushing.

The bank book of the depositor must accompany this order."

(17) Blake v. Coleman, 22 Wis. 396.
(18) White v. Cushing, 88 Me. 339.

Since the paper must be unconditional *on its face,* a promise to pay, if a certain event has already happened before the note is delivered, is not a promissory note, although the specified event had really occurred before the making of the promise (19). Nor will the subsequent happening of a named contingency make the instrument a bill or note after that time. On its face the instrument is still conditional. "An instrument payable upon a contingency is not negotiable, and the happening of the event does not cure the defect" (20).

§ 14. **Promise or order to pay out of particular fund is conditional.** If A sells B a mine, and takes in payment a written promise by B to pay "out of the proceeds" of the ore to be mined, such promise is clearly a contingent obligation and not a note, because there may never be any proceeds (21). So, if an employee draws an order on his employer, directing a payment to be made out of the salary to become due the employee, the order is not a bill. The salary may never become due (22).

But if a depositor, having two accounts with a bank, draws a check on the bank, "Please pay A, or order, $100 and charge account No. 1," it is a negotiable instrument. The order is not in terms conditional upon the existence of money in the bank to the credit of the depositor, but is an imperative direction to the bank to pay A, or order, $100. The words "charge account No. 1," are simply an indication to the bank of the account to which the check is

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(19) Ames' Cases on Bills & Notes, Vol. II, 828.
(20) Neg. Inst. Law, sec. 4.
(21) Worden v. Dodge, 4 Denio 159 (N. Y.).
(22) Josselyn v. Lacier, 10 Modern, 294, 317.

to be charged *after* it is paid. The fact that the bank might not pay the check, if the depositor's account was not good, does not make the order conditional on its face, and the face of the instrument is controlling in determining its negotiability.

§ 15. **Same (continued).** This rule is illustrated in Redman v. Adams (23), where the following order was held a bill:

"Castine, Jan. 5, 1860.

For value received please pay to order of G. F. and C. W. Tilden forty dollars, and charge same against whatever amount may be due me for my share of fish caught on board schooner "Morning Star," for the fishing season of 1860. Yours etc.,

Frank R. Blake.

To Messrs. Adams & Co.

Accepted to pay.—Adams & Co."

The court said: "The order requires the drawees to pay to the order of G. F. and C. W. Tilden the sum of forty dollars, absolutely and without contingency. A means of reimbursement is indicated to the drawees in the words appended, 'and charge the same against whatever amount may be due me for my share of fish, etc.,' but the payment of the order is not made to depend upon his having any share of fish, nor is the call limited to the proceeds thereof."

An instrument in which A promises B "to pay $50 of the $100 which I owe you" is not conditional upon the ex-

(23) 51 Me. 429.

istence of the debt, for the face of the instrument assumes its existence. It is very different from a promise to pay $50 of the $100 I owe you, *if* I owe anything. Upon this reasoning the following was held a bill:

"Mr. Brigham, Dear Sir: You will please pay Elisha Wells $30, which is due me for the two-horse wagon bought last spring, and this may be your receipt."

The order was an absolute one to pay a debt *stated* to be due. If it in fact appeared that Brigham did not owe the drawer of the order, still the order would be absolute on its face (24).

§ 16. **Statement of consideration does not make instrument conditional.** The statement of the consideration for for which the instrument was given does not make it conditional upon the consideration stated having been performed. Thus in Mabie v. Johnson (25), in consideration of a machine and a warranty thereof, of which warranty there was in fact a breach when the note was delivered, Johnson gave his note as follows:

"Guilford, Nov. 29, 1870.

For one Hinckley knitting machine warranted I promise to pay J. H. Wells or bearer $30 one year from date with use."

Part of the consideration was the warranty, which was not fulfilled, yet this fact did not make the note conditional on its face, and the instrument was held a promissory note.

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(24) Wells v. Brigham, 6 Cush. 6.
(25) 8 Hun, 309 (N. Y.).

The result would of course have been different, if the paper had read, "For one Hinckley knitting machine, if as warranted, I promise," etc.

Nor does the statement of a consideration to be performed after the note is delivered, make it conditional upon the consideration being performed. Again there is nothing in the words of the note making it conditional. Upon this ground the following instrument was held a promissory note (26):

$300. "Chicago, Mar. 5, 1887.
On July 1, 1887, we promise to pay D. Dalziel, or order, the sum of three hundred dollars, for the privilege of one framed advertising sign, size — x — inches, one end of each of one hundred and fifty-nine street cars of the North Chicago City Railway Co., for a term of three months, from May 15, 1887. Siegel, Cooper & Co."

The most striking example of the rule that to deprive a negotiable instrument of its character as such, the condition must appear within its four corners, is the case of Jury v. Barker (27), in which a note in this form—

"London, 29th Oct., 1857.
I promise to pay to Mr. J. C. Saunders or his order, at three months after date, the sum of one hundred pounds, as per memorandum of agreement.
Henry John Barker.
Payable at 105 Upper Thames Street, London."

(26) Siegel v. Chicago Bank, 131 Ill. 569.
(27) Ellis, B. & E. 459.

was held a promissory note. The effect of the words "as per memorandum of agreement" will not charge any purchaser of the note with notice of the agreement referred to or subject him to any defenses based upon its provisions.

The N. I. L. (27a) codifies the rules applied in these cases in these words:

Sec. 3. An unqualified order or promise to pay is unconditional within the meaning of this act, though coupled with:

1. An indication of a particular fund out of which reimbursement is to be made, or a particular account to be debited with the amount; or

2. A statement of the transaction which gives rise to the instrument.

But an order or promise to pay out of a particular fund is not unconditional.

§ 17. **Promise or order must be certain in amount payable at maturity.** The defendant's written promise to pay plaintiffs, or order, 13 pounds on demand for value received with interest at 5 per cent. "and all fines according to rule" is not a promissory note, because of the uncertainty as to the sum due on the instrument (28). A stipulation for interest at a given rate, however, does not make the sum payable uncertain; for, taking the data on the face of the note, i. e., the date the principal sum is due,

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(27a) The Negotiable Instruments Law will be abbreviated "N. I. L." in this article.

(28) Ayrey v. Fearnsides, 4 Meeson & Welsby, 168.

its amount, and the rate of interest, the amount of interest payable at maturity is a mere matter of computation. The same result follows if the promise is simply to pay interest, without specifying a rate, for the legal rate is then payable. It is true that if the instrument is not paid at maturity, when, if ever, it will be paid is uncertain, and that in consequence the amount of interest finally payable can not be ascertained from the instrument. This, however, is immaterial for the canon of certainty refers to the maturity of the instrument. For the same reason it is held that bills and notes specifying different rates of interest, before and after maturity, are certain in amount. For example the following is a valid note (29):

$100. "Good Thunder, July 24, 1882.

For value received on or before the first day of January, 1884, I, or we, or either of us, promise to pay to the order of D. M. Osborne and Co. the sum of one hundred dollars, at the office of Gebhard and Moore, in Mankato, with interest at ten per cent. per annum from date until paid; seven, if paid when due.

W. J. B. Crane."

§ 18. **Costs of collection and attorney's fees.** On the same principle, a stipulation to pay in addition to principal and interest, costs of collection and attorney's fees, if the bill or note is not paid at maturity, does not affect its negotiability. The sum payable at maturity is certain (30).

(29) Smith v. Crane, 33 Minn. 144.
(30) Gara v. Louisville Banking Co., 11 Bush 180 (Ky.).

§ 19. **Instruments payable with exchange.** An exception to the requirement of certainty is based upon the commercial usage of making bills and notes payable at one place, with exchange on another. This usage is recognized, although its recognition is technically a violation of the canon of certainty. Thus a note payable in St. Paul, Minn., "with current exchange on New York City" is good (31).

§ 20. **Instruments payable in instalments.** A bill or note payable in instalments, for example, $100 in ten payments of $10 each every 30 days, is unquestionably certain as to amount. So also is such an instrument which further provides that, in case of a default in the payment of any instalment, the whole amount shall at once become due. Whether such a stipulation for accelerating payment makes the instrument uncertain as to *time* of payment will be considered below. The N. I. L. thus states the law:

Sec. 2. The sum payable is a sum certain within the meaning of this act, although it is to be paid:

1. With interest; or

2. By stated instalments; or

3. By stated instalments, with a provision that upon default in payment of any instalment or of interest, the whole shall become due; or

4. With exchange, whether at a fixed rate or at the current rate; or

5. With costs of collection or an attorney's fee, in case payment shall not be made at maturity.

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(31) Hastings v. Thompson, 54 Minn. 184.

§ 21. **Promise or order must be certain as to the time of payment.** There is a literal compliance with this rule in the ordinary bill or note payable "on Jan. 1, 1909," or "10 days after date." The familiar case of negotiable instruments payable on demand is an exception based on business usage. Notwithstanding the uncertainty of the time of death, a promise in this form: "Thirty days after death, I promise to pay Cornelius Carnwright $1500, with interest," is held a promissory note (32). So also, an instrument payable at the maker's option on or before a day named (33), or "within one year after date" (34) is a promissory note. Further, a note for a specified sum payable in instalments, the size of which depends upon the maker's option, is negotiable paper. For example the following was held a promissory note in Cooke v. Horn (35):

£170. "25th April, 1872.

We promise to pay M. H. Cooke and Co. £170, with interest thereon at the rate of 5 per cent. per annum, as follows: the first payment, to wit, £40 or more, to be made on the 1st Feb., 1873, and £5 on the first day of each month following, until this note and interest shall be fully satisfied. And in case default shall be made in payment of any of the said instalments, the full amount then remaining due in respect of the said note and interest shall be forthwith payable."

Such an instrument, it is said by the court, is no more un-

(32) Carnwright v. Gray, 127 N. Y. 92.
(33) Mattison v. Marks, 31 Mich. 421.
(34) Leader v. Plante, 95 Me. 339.
(35) 29 Law Times Reps. 369.

certain as to the time of payment than a note payable "on or before" a given date. The time within which, at the latest, the note must be paid is described in it. Again, a bill or note payable in instalments, with a provision that upon default in the payment of any instalment the whole sum shall become payable, is held for the same reason as in Cooke v. Horn to be sufficiently certain as to the time of payment (36). On the other hand, the following instrument is held not to be a note:

"For value received, I promise to pay Oliver James Rice or order the sum of $1500 when he is 21 years of age with interest from date. (Sgd.) Rachel G. Rice. (Dated) Mount Morns, Jan. 1, 1890,"

because Oliver might never attain his majority (37). A rule which would state the effect of these decisions would have to read something like this: A negotiable instrument must be (a) payable on demand, or (b) payable not later than a particular day fixed either in the instrument or with reference to the happening of an event certain to happen, or (c) payable after demand at a date fixed as in (b).

§ 22. Instruments payable on demand.

"An instrument is payable on demand: (1) Where it is expressed to be payable on demand, or at sight, or on presentation; or (2) in which no time of payment is expressed" (38).

Thus, a bill or note is sufficient which specifies no day of payment, because by construction it is payable on demand.

(36) Carlon v. Kenealy, 12 Meeson & Welsby, 139.
(37) Rice v. Rice, 60 N. Y. Supp. 97.
(38) Neg. Inst. Law, sec. 7.

But a negotiable instrument must not specify a date of payment, and at the same time give the holder the right to mature the instrument at any time. The specified date of payment precludes the construction that the instrument is payable on demand. For example, an instrument payable five years after date, with a provision that the holder could at his option at any time before maturity enter judgment against the maker for the full amount, is not a promissory note (39). The same reasoning has been applied to instruments in the form of promissory notes payable on a day named, which contained this stipulation: "The makers and indorsers of this obligation further expressly agree that the payee, or his assigns, may extend the time of payment thereof from time to time indefinitely as he or they may see fit." The courts refuse to treat such a note as payable on demand after the day named, although such seems to be its effect, and hold that it is not negotiable paper (40). A bill or note, then, unless it falls within the definition of a demand instrument, may not give the holder a right to make it payable at his option. It should be noted that this proposition is not inconsistent with the rule previously stated (§ 21) that a note may be made payable on or before a specified date at the *maker's* option; or if payable in instalments, that it may become due upon the failure to pay one instalment. In neither of these cases is it the *holder's* option which makes the instrument payable in advance. The N. I. L. provides:

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(39) Wisconsin Yearly Meeting v. Babler, 115 Wis. 289. See also Commercial Bank v. Consumers' Co., 16 App. Cases (D. C.) 186; Louisville Co. v. Gray, 123 Ala. 251.

(40) Woodbury v. Roberts, 59 Iowa, 348.

Sec. 4. An instrument is payable at a determinable future time, within the meaning of this act, which is expressed to be payable:

(1) At a fixed period after date or sight; or

(2) On or before a fixed or determinable future time specified therein; or

(3) On or at a fixed period after the occurrence of a specified event, which is certain to happen, though the time of happening be uncertain.

§ 23. **Promise or order must be to pay money.** Thus, a written contract, "Two years from date for value received, I promise to pay J. S. King or bearer one ounce of gold," is not a promissory note. Unminted gold is not money (41). For the same reason a promise to pay $2180 in bank checks is not a note (42). An instrument made in Michigan payable in Canada in Canada money is a promissory note (43), but an instrument made in New York and payable there in Canada money is not a promissory note (44). These two cases show that a bill or note may be made payable in the money of any country, but the money designated must be that of the country where the paper is payable. The reason for this rule lies in the definition of money. Money is legal tender, i. e., that which by law is tenderable for debts. While Canada money is legal tender in Canada, it certainly is not in New York. In New York it is a commodity. But a note payable in the United States, containing a promise to pay 10,000 francs

(41) Roberts v. Smith, 58 Vt. 492.
(42) National Bank v. National Bank, 84 Tex. 40.
(43) Black v. Ward, 27 Mich. 191.
(44) Thompson v. Sloan, 23 Wend. 71.

in the money of the United States, is negotiable. Although the *amount* payable is expressed in foreign money, the *medium of payment* is legal tender of the United States (45). Even if the instrument did not expressly provide for payment in United States money, the result should be the same, for, by implication, the instrument is payable in the legal tender of the country where it is payable. For example, a note containing a promise to pay 10,000 francs, payable in the United States, is by implication payable in money of the United States: "10,000 francs" is the measure of the amount payable, rather than an indication of the medium of payment (46).

§ 24. **Current funds.** A bill or note which indicates the medium of payment by any phrase which according to mercantile usage means money, is negotiable. Of such phrases those in most common use are "currency," and "current funds." For example, the following certificate of deposit is payable in money, and therefore is a promissory note (47):

"The 1st National Bank, Dexter, Me.,
Jan. 6, 1897.

Olivia Hodge has deposited in this bank $560 payable in current funds to the order of herself on return of this certificate properly indorsed. Int. at 3% per annum if on deposit six months.

C. N. Sawyer, Cash."

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(45) Thompson v. Sloan, note 44, above.

(46) Thompson v. Sloan, note 44, above; Hogue v. Williamson, 85 Tex. 553.

(47) Hatch v. Bank, 94 Me. 348.

§ 25. **Particular kind of money.** The N. I. L. (48) provides that a bill or note may "designate a particular kind of current money in which payment is to be made." This means simply that a particular kind of legal tender, such as gold eagles, or copper cents, may be prescribed as the medium of payment.

§ 26. **Bill or note must order or promise payment of money only.** A promise to pay A or order $100, *and* to deliver him or order a horse on Jan. 1 is not a note. Nor is a promise either to pay A or order $100, *or* to deliver a horse on Jan. 1, at the promisor's option, a promissory note. But a promise to pay A or order either $100, or, at his option, to deliver him a horse, is a promissory note. In the first case there is a promise to do something in addition to the payment of money. In the second, the promise to pay money is conditional upon the promisor's exercising his option. In the third, the promise to pay money is absolute, and, in case the holder elects to take money, the promisor is bound to deliver nothing in addition. An example of the third case is Hodges v. Shuler (49) where the court held the following instrument a promissory note:

"Rutland and Burlington Railroad Company.

No. 253. $1,000.

Boston, April 1, 1850.

In four years from date, for value received, the Rutland and Burlington Railroad Company promises to pay in Boston, to Messrs. W. S. & D. W. Shuler, or order $1000, with interest thereon, payable semi-annually, as per in-

(48) Sec. 6, subd. 5.

(49) 22 N. Y. 114.

terest warrants hereto attached, as the same shall become due; or upon the surrender of this note, together with the interest warrants, not due, to the treasurer, at any time until six months of its maturity, he shall issue to the holder thereof ten shares in the capital stock in said company in exchange therefor, in which case interest shall be paid to the date to which a dividend of profits shall have been previously declared, the holder not being entitled to both interest and accruing profits during the same period.

T. Follett, President.
Sam. Henshaw, Treasurer."

It seems clear that recitals in an instrument, that collateral security for it has been given and authorizing the sale of the collateral (50), or authorizing the entry of a judgment by default against the maker, in case of non-payment (51), or waiving the benefit of exemption laws (52), do not encroach upon the rule just stated, or any of the other rules we have discussed. The N. I. L. says:

Sec. 5. An instrument which contains an order or promise to do any act in addition to the payment of money is not negotiable. But the negotiable character of an instrument otherwise negotiable is not affected by a provision, which:

1. Authorizes the sale of collateral securities in case the instrument be not paid at maturity; or

2. Authorizes a confession of judgment if the instrument be not paid at maturity; or

(50) Valley Bank v. Crowell, 148 Pa. St. 284.
(51) Osborn v. Hawley, 19 Ohio, 130.
(52) Zimmerman v. Anderson, 67 Pa. St. 421.

3. Waives the benefit of any law intended for the advantage or protection of the obligor; or

4. Gives the holder an election to require something to be done in lieu of payment of money.

But nothing in this section shall validate any provision or stipulation otherwise illegal.

§ 27. **Certainty of parties: Requisite parties.** It is impossible to conceive of a promissory note without a maker, i. e. a promisor, and a payee to whom the promise runs; or of a bill of exchange without a drawer who writes the order, a drawee to whom the order is directed, and a payee in whose favor it is drawn. A note presupposes two parties and a bill three. However, the formal validity of a bill or note is not affected by the fact that one person is designated upon its face in more than one of the several capacities. Nothing is more common in business than making a note payable to the maker's order. In such a case, of course, the payee could not bring an action against himself as maker. But, in respect of form, the note is valid, and, when it is transferred to a second person, the instrument becomes an enforceable obligation. So, in the case of a bill drawn payable to the drawer. Although no obligation arises on the instrument in favor of the payee against himself as drawer, upon a transfer of the instrument to a third person the drawer becomes liable as such to the transferee. In like manner the same person may be designated as drawee and payee in the instrument. Here again the drawee's acceptance, or promise to pay, obviously puts him under no duty to himself as payee. But,

upon a transfer to a third person, the acceptance becomes operative.

The N. I. L. (53) provides that a negotiable instrument "may be drawn payable to the order of: (1) A payee who is not maker, drawer or drawee; or (2) the drawer or maker; or (3) the drawee."

§ 28. **Same (continued).** Upon the same principle, an instrument in which the same person is named as drawer, payee, and drawee, is sufficient in point of form, but is of course inoperative until transferred. Thus an indictment for forging the name of J. M. Stevenson to the following instrument, describing it as a bill of exchange, was held sufficient to sustain a conviction (54):

"Three months after date pay to the order of myself eight hundred and fifty dollars, value received, and charge the same to the account of your obedient servant, J. S. Butterick. To J. S. Butterick, Sterling, Mass." (On the face): "Payable at the Lancaster N. Bank, J. S. Butterick." (Indorsed): "J. S. Butterick." "J. M. Stevenson."

Whether such an instrument is a bill of exchange or a promissory note is a different question. Although in form a bill, it seems that, since the only obligation arising upon it is from Butterick to the holder, it is in substance a promissory note. In the case before us the court said that the paper might have been described as a promissory note. The view of the court is adopted by the N. I. L. (55):

(53) Sec. 8.
(54) Commonwealth v. Butterick, 100 Mass. 12.
(55) Sec. 17, subd. 5.

"Where the instrument is so ambiguous that there is a doubt whether it is a bill or note, the holder may treat it as either at his election." Again, the Law says (56):

"When, in a bill, drawer and drawee are the same person . . . the holder may treat the instrument at his option either as a bill of exchange or a promissory note."

§ 29. **Certainty of parties: Maker or drawer.** The person who is the maker of a note or drawer of a bill is indicated by his signature thereto. The instrument "must be signed by the maker or drawer" (57). If there is no signature by the maker or drawer, the instrument is not a bill or note (58). Subscription, i. e., signing at the end is not required. Thus "I, John Smith, promise to pay A or order, $100 on demand," is John Smith's note, if the name "John Smith" in the body of the instrument is intended by him as his signature (59).

Any written symbol or mark is a sufficient signature, for example "1, 2, 8," provided the maker intended to bind himself by the figures as his signature (60). It follows that "one who signs in a trade or assumed name will be liable to the same extent as if he had signed in his own name" (61).

But, "no person is liable on the instrument whose signature does not appear thereon" (62). Thus Rowlestone, al-

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(56) Neg. Inst. Law, sec. 130.
(57) Neg. Inst. Law, sec. 1.
(58) Stoessiger v. Ry. Co., 3 Ellis & B. 549.
(59) Taylor v. Dobbins, 1 Strange, 399.
(60) Brown v. Bank, 6 Hill, 443.
(61) Neg. Inst. Law, sec. 18.
(62) Neg. Inst. Law, sec. 18.

though Walker was admittedly acting as agent for him to the knowledge of Siffkin, was not liable on the following note (63):

"Two months after date, I promise to pay J. Siffkin or order 300 pounds for value received. (Sgd) Thos. Walker."

And conversely, if Walker were sued on the instrument, his agency would be no defence because he has made it his note by signing it as maker (64).

§ 30. **Same: Signatures of agents.** Let us suppose, however, that Walker had added the word "agent" after his signature, would this discharge Walker from liability on the note? Would it make his principal, Rowlestone, liable thereon? The second question we may dismiss at once with a negative. Under no circumstances could Rowlestone be held on a note which had not been signed in his name, either by him in person or by his authorized agent (65). The first question depends for its answer upon whether or not the holder of the instrument knew that Walker was acting as agent and did not intend to bind himself. If the holder did know this, then, according to the later authorities, the signature "Walker, agent," would not bind Walker. But if the holder did not know of these circumstances, Walker would be bound. The mere addition of the word "agent" after Walker's signature, however, would not by itself notify the holder of Walker's intention not to be bound. The word is treated by the

(63) Siffkin v. Walker, 2 Campbell, 308.
(64) Leadbitter v. Farrow, 5 Maule & S. 345.
(65) Manufacturer's Bank v. Love, 13 N. Y. App. Div. 561.

courts as of no more effect than a word or phrase added by way of more complete description of the signer, as for example, "of Madison, Wis.," "Instructor in X College." "Conductor on X Railroad," etc. In Keidan v. Winegar (66) the plaintiff took a note from the defendant for a debt due to plaintiff from defendant's principal, both parties treating the obligation as that of the principal. The note was in this form:

"Dec. 22, 1887. 90 days after date, I promise to pay to the order of Geo. Keidan $336.96 at the Old Nat. Bank of Grand Rapids, Mich., value received, with interest at the rate of 6% per annum until paid. (Sgd) W. G. Winegar, Agt."

It was held that Winegar was not liable.

In First National Bank v. Wallis (67), however, a note in the form below was held to be the note of Wallis and Smith, notwithstanding the form of the signature and the marginal writing, it not appearing that the plaintiff took the instrument knowing that Wallis and Smith intended to bind the corporation and not themselves.

"Wallis Iron Works

"Jan. 20, 1893.

"Three months after date, we promise to pay to the order of H. Stentzer & Co. $100 at the 1st National Bank of Jersey City, value received.

"Wm. T. Wallis, President,
"George T. Smith, Treasurer."

(66) 95 Mich. 431.
(67) 150 N. Y. 455.

The words "President" and "Treasurer" were considered as mere words of description or identification. The "Wallis Iron Works" in the margin was not considered significant, because any one might use one of the Iron Company's blank forms.

§ 31. **Same (continued).** The questions arising upon irregular forms of signatures by agents are difficult, the decisions are conflicting, and the only safe course is to use an unquestioned mode of signature. Examples of signatures which undoubtedly bind the principal X, whether individual or corporation, and not the agent, A, are: "X by A;" "A for X;" "by authority of X, A;" "X, by A, agent;" "X, by A, president;" etc. Of course the agent may sign his principal's name without adding his name.

If the agent signs in his own name simply, we have seen that he, and he only, is bound. But if the agent signs for his principal in proper form, the principal is the only person who can be held on the instrument. If the agent signs for his principal in proper form to bind him, but is not authorized to sign, the principal is not bound. Is the agent liable? Obviously he can not be held on the bill or note because it does not bear his signature as maker. He is, however, liable to the person he has misled for the resulting damage, if any, in an action upon his warranty of authority (68). The provisions of the N. I. L. are as follows:

Sec. 19. The signature of any party may be made by a

(68) White v. Madison, 26 N. Y. 117.

duly authorized agent. No particular form of appointment is necessary for this purpose; and the authority of the agent may be established as in other cases of agency.

Sec. 20. Where the instrument contains or a person adds to his signature words indicating that he signs for or on behalf of a principal, or in a representative capacity, he is not liable on the instrument if he was duly authorized; but the mere addition of words describing him as an agent, or as filling a representative character, without disclosing his principal, does not exempt him from personal liability.

These sections have not changed the law as above set forth, but merely codify it (69).

§ 32. Certainty of parties: Payee.

"Where the instrument is payable to order, the payee must be named or otherwise indicated therein with reasonable certainty" (70).

Thus, the following paper was held not to be a check, no payee being named: "Lansing State Savings Bank of Lansing. Pay to the order of .... $970. (Sgd.) John R. Gordon" (71). And an instrument in the form of a note payable to "Charles R. Whitesell and others or order" is not a note because the payees are not certain (72).

If the payee is designated in the instrument, the mode

(69) Megowan v. Peterson, 173 N. Y. 1.
(70) Neg. Inst. Law, sec. 8.
(71) Gordon v. Bank, 133 Mich. 143.
(72) Gordon v. Anderson, 83 Iowa, 224.

of designation, if reasonably certain, is immaterial. Thus, the payee may be described by a name other than his usual name or his trade name. In Willis v. Barrett (73), Elizabeth Willis was allowed to recover as payee on a note payable to Elizabeth Willison, upon proof that she was the person described by the name on its face. And an instrument in the form of a note payable to "F. B. Bridgman's estate" was held to be a note sufficiently designating Bridgman's executor as payee (74). Upon the same principle a bill or note payable to "X, cashier" is presumably payable, not to X, but to the bank of which X is cashier. Business usage makes the words "X, cashier" mean the bank of which he is an officer (75). The same rule of interpretation is applied to a note payable to any fiscal officer of a bank or corporation. The N. I. L. says:

Sec. 42. Where an instrument is drawn or indorsed to a person as "Cashier" or other fiscal officer of a bank or corporation, it is deemed prima facie to be payable to the bank or corporation of which he is such officer, and may be negotiated by either the indorsement of the bank or corporation, or the indorsement of the officer.

§ 33. **Fictitious payees.** Suppose, however, the name used in a note is not intended by the maker to designate any person bearing that name, or any other person, but that the maker intends to indorse and issue the note himself. Such a note might well be treated as payable to him-

(73) 2 Starkie, 29.
(74) Shaw v. Smith, 150 Mass. 166.
(75) First National Bank v. Hall, 44 N. Y. 395.

self by the fictitious name, but the law seems to be that such a note, when indorsed by the maker, is treated as payable to bearer. The rule is thus stated in Sec. 9, subd. 3 of the N. I. L.:

"The instrument is payable to bearer . . . when it is payable to the order of a fictitious or non-existing person, and such fact was known to the person making it so payable."

The reason for the rule very clearly appears to be that if the instrument were treated as payable to order, its indorsement and transfer by the maker, who is not named as payee, would not pass title to the instrument, and the transferee would get no rights on the instrument. Thus the maker by transferring the note would be perpetrating a fraud upon the transferee. To avoid this result the instrument is treated as payable to bearer. If the maker supposed that the name in the note designated a particular individual, and intended it to be payable to the person whom he supposed he had designated, but in fact the name did not designate any particular individual, the note is not payable to bearer, and the maker is not liable on the note, if it is negotiated. For example, in Minet v. Gibson (76), Livesey & Co. drew a bill of exchange on defendant payable to "J. White." The defendant accepted the bill. "J. White" was not intended to designate any person, and this was known to the defendants. Livesey & Co. then indorsed the bill to the plaintiffs. It was held that the defendants were liable on the bill. It was no defense that

(76) 3 Term Rep. 481.

the bill had not been indorsed by "J. White," because the acceptor knew that "J. White" was, as the N. I. L. says, "a fictitious or non-existing person." In Shipman v. Bank (77) the plaintiff's clerk prepared checks payable to a name which was not intended by the clerk to designate any person, but the plaintiff when he signed them supposed there was a person designated by the name. The clerk indorsed the name on the checks and they were paid by the defendant bank out of plaintiff's account. It was held that the plaintiff could recover the amount of the checks from the bank. The plaintiff did not know that the payee "was a fictitious or non-existing person."

§ 34. **Alternative payees.** Before the enactment of the Negotiable Instruments Law it was held that an instrument payable to "A *or* B, or order" was not a bill or note, an uncertainty as to the payee existing because of the option of the maker or acceptor to pay either one or the other. But the N. I. L. provides that a bill or note may be payable to "One or some of several payees" (78). Of course, there would be no objection to an instrument payable to several jointly, as to A, B, and C, because here the payee of the obligation is the group as a unit (79).

§ 35. **Successive holders of office as payees.** An instrument payable to "A, executor of B's estate and his successors," or to "A, treasurer of the B corporation and his successors" is negotiable. Although it may be uncertain who will be the holder of the office when the instrument becomes payable, there can not be more than one

(77) 126 N. Y. 318.
(78) Sec. 8, subd. 5.
(79) Sec. 8, subd. 4.

person at any given time who is payee of the instrument, and the paper describes him with reasonable certainty. Accordingly the N. I. L. (80) provides that a bill or note may be payable to "the holder of an office for the time being." This sub-section, however, does not apply to instruments payable to the officers of unincorporated associations, for in such associations there are no "offices." In consequence, an instrument payable to "A, treasurer of X Society [unincorporated] or his successors," must be treated either as payable to A, the words "treasurer," etc., being disregarded, in which event it is a valid negotiable instrument (81); or as payable to whomever happens to be the treasurer at the time of payment, in which event it is uncertain as to payee, and so not a bill or note (82). The former construction seems the more reasonable.

§ 36. **Certainty of parties: Drawee.** A bill is an order "addressed by one person to another" (83). "A bill may be addressed to two or more drawees jointly, whether they are partners or not; but not to two or more drawees in the alternative or in succession" (84). "Where the instrument is addressed to a drawee, he must be named or otherwise indicated therein with reasonable certainty" (85).

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(80) Sec. 8 (6).
(81) Patton v. Melville, 21 U. C. Q. B. 263.
(82) Cowie v. Sterling, 6 Ellis & B. 333.
(83) Neg. Inst. Law, sec. 126.
(84) Neg. Inst. Law, sec. 128.
(85) Neg. Inst. Law, sec. 1, subd. 5.

Thus the following for want of a drawee is not a bill (86):

$2771.62. "Montevallo, June 1, 1858.

Ten months after date pay to the order of John S. Storrs, two thousand seven hundred and seventy-one and 62/100 dollars, value received, and charge to account of

To........, Mobile, Ala. D. E. Watrous."

The decision ought to be the same even if "To........, Mobile, Ala.," had not appeared in the corner of the instrument, where the name of the drawee usually appears, and there are cases so holding (87). In Peto v. Reynolds, it was held that if a third person promised to pay such a defective bill, the promise of the third person made the instrument his promissory note. The promise was not an acceptance, because only a bill can be accepted; and the instrument was not a bill, because not addressed to a drawee.

§ 37. **Same (continued).** Notwithstanding these cases and the undoubted soundness of their reasoning, it is held that an order in the form of a bill of exchange, in which no drawee is designated, is in effect an order drawn on the drawer himself, and that he is liable on the instrument either as drawer of a bill or as maker of a promissory note (88). These decisions, however, are indefensible: the signer of the order is not liable as drawer of a bill, because there is no bill for want of a drawee; he is not liable as

(86) Watrous v. Halbrook, 39 Tex. 573.

(87) Forward v. Thompson, 12 U. C. Q. B. 103; Peto v. Reynolds. 9 Exchequer, 410.

(88) Almy v. Winslow, 126 Mass. 342; Funk v. Babbitt, 156 Ill. 408.

maker of a note, because the instrument contains no promise on his part to pay. These cases are based on a supposed analogy between a bill which is not addressed to a drawee, and an instrument in which the same person is designated as drawer and drawee. In the latter case the instrument is a valid bill in point of form, and, if the drawer refused to accept as drawee, he is liable as drawer because the instrument has been dishonored by non-acceptance (89). The case is like Commonwealth v. Butterick (90), and the instrument is in substance a note (91). But not only must the instrument be addressed to a drawee, in addition he must be named or designated with reasonable certainty. If the name of the drawee is not used, a trade name or any reasonably certain description may be. Thus the designation in the following bill is sufficient (92):

"Mobile, Nov. 16, 1867.

Steamer C. W. Dorrance and owners will please pay W. B. Seawell & Co. twenty-two hundred dollars and charge the same to the account of yours, etc.

R. Swan.

(Across the face) St'r Dorrance, per G. M. McConico, agent. (Indorsed) Pay R. Swan, or order, without recourse on us. W. B. Seawell.

R. Swan.

Pay James M. Brainard, or order."

(89) Allen v. Assurance Co., 9 C. B. 574.
(90) § 28, above.
(91) Sec. 130, Neg. Inst. Law and § 28, above.
(92) Alabama Coal Co. v. Brainard, 35 Ala. 476.

It is even held that writing an address on the instrument, which appears to be a designation of the place of payment rather than a description of the person to pay, may be interpreted as a mode of designating the person there residing, or doing business, as the drawee. Thus John Morson & Co. was held drawee of an instrument expressly naming no drawee, but addressed, "At Messrs. John Morson & Co." (93). The same interpretation was applied to instruments addressed "Payable at No. 1 Wilmot Street, Opposite the Lamb, Bethnal Green, London" (94); and "General Provision Warehouse," etc. (95).

§ 38. **Negotiable instrument must be payable to order or bearer.** Even if an instrument conforms to all of the foregoing requirements, it is not negotiable unless it is payable to order or to bearer.

§ 39. **Order instruments.**

"An instrument is payable to order when it is drawn payable to the order of a specified person or to him or his order" (96).

In the language just quoted, the N. I. L. thus fully recognizes the usual form of bills, notes, and checks payable to order, which are "Pay A, or order," and "Pay to the order of A." But it is thought that the N. I. L. does not exclude the use of any other appropriate expressions indicating an intention to make the instrument payable to the payee's order. For example the following would seem to be a negotiable note: "On demand I promise to pay A

(93) Shuttleworth v. Stevens, 1 Campbell, 407.
(94) Gray v. Milner, 8 Taunton, 739.
(95) Regina v. Hawkes, 2 Moody Crown Cases, 60.
(96) Neg. Inst. Law, sec. 8.

$100. *This note is negotiable.* (Sgd) X" (97). Before the N. I. L. instruments payable to "A, or assigns" were held negotiable (98); but under the N. I. L. a contrary ruling has been made (99). The later decision seems preferable, apart from the N. I. L., because, as we shall see, an assignment is very different from an indorsement, and an assignee stands in a different position from an indorsee.

§ **40. Bearer instruments.**

"The instrument is payable to bearer: (1) When it is expressed to be so payable; or (2) when it is payable to a person named therein or bearer; or . . . (4) when the name of the payee does not purport to be the name of any person" (100).

Thus, by the words of the N. I. L. an instrument reading "Pay to bearer" or "Pay to A, or bearer" is negotiable. But a note payable to "the bearer, A" is not (101). In such a case the word "bearer" is used in addition to the payee's name further to describe and identify him. For a similar reason the following note was held payable to order and not to bearer (102):

"Due the bearer hereof, £3, 18s, 10d., which I promise to pay to Abraham Thompson, or order, on demand, as witness my hand, this 22d 11th month, 1803.

(Signed) Jordan Cock."

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(97) See Raymond v. Middleton, 29 Pa. St. 529; Stadler v. Bank, 22 Mont. 190.

(98) Brainerd v. R. R., 25 N. Y. 496.

(99) Zander v. Trust Co., 78 N. Y. Supp. 900.

(100) Neg. Inst. Law, sec. 9.

(101) Bloomingdale v. Bank, 68 N. Y. Supp. 35.

(102) Cock v. Fellows, 1 Johns. 143.

The use of the word bearer is not necessary. Any word or phrase of equivalent significance is sufficient. Thus a note payable to "M. Owens, or holder" is payable to bearer (103).

§ 41. **Same: Payee not a person.** If the designation of the payee does not purport to designate an individual, the instrument is payable to bearer. Before the N. I. L., the cases in which this rule was applied were cases where the designation of the "impersonal payee" was followed by words of negotiability, i. e., order or bearer. For example, instruments payable to "bills payable, or order" (104), and to "the order of 1658" (105), were held payable to bearer. Checks payable to "the order of cash" are familiar examples of this kind of bearer paper. The reason given by the courts for the rule was that the words of negotiability show an intention that the paper shall be transferable, and, since indorsement by the "impersonal payee" is impossible, the instrument must be interpreted as payable to bearer and transferable without indorsement. If that is the reason for the rule, it would not be applicable where the words "order" or "bearer" were omitted. Though the language of the N. I. L. is broad enough to cover instruments in which words of negotiability do not appear, it is not believed that it was intended to make such instruments negotiable.

§ 42. **Date of instrument.** The only purpose of a date is to fix the time of payment. In an instrument payable on a specified day, e. g., Jan. 1, 1910, the date fulfills no

(103) Putnam v. Crymes, 1 McMullan's Law Rep. (S. C.) 9.
(104) Mechanics' Bank v. Straiton, 3 Keyes, 365 (N. Y.).
(105) Willets v. Bank, 2 Duer, 121 (N. Y.).

office; but in a note payable after date, e. g., "30 days after date," the date written on the instrument fixes the day of payment. Since the only purpose of the date is that indicated, the maker may regulate the day of payment by dating the instrument "back" or "ahead." Thus, if on Jan. 1, 1910, he issued his note dated "Dec. 1, 1909," payable "three months after date," it would be payable March 1, and not April 1, 1910. If the same instrument were dated Feb. 1, 1910, it would be payable May 1, 1910; and the instrument in such a case would be the valid obligation of the maker or drawer from the day of its issue on Jan. 1, notwithstanding it bore date a month later (106). If an instrument payable "three months after date" is issued undated, it is payable three months after the day of its issue (107). If such an instrument is issued on Jan. 1, 1910, but is dated by mistake "Jan. 1, 1909," the instrument is nevertheless payable three months after the day of its issue, i. e., April 1, 1910 (108).

The N. I. L. sums up the rules on this subject as follows:

Sec. 6. The validity and negotiable character of an instrument are not affected by the fact that: (1) It is not dated. . . .

Sec. 17. (3) Where the instrument is not dated, it will be considered to be dated as of the time it was issued.

Sec. 11. Where the instrument, or an acceptance, or any indorsement thereon is dated, such date is deemed

(106) Pasmore v. North, 13 East, 517.

(107) Seldonridge v. Connable, 32 Ind. 375. As to the right of a holder to fill in the date in such a case, and the rights of the parties where a wrong date is inserted, see §§ 53-55, below.

(108) Almich v. Downey, 45 Minn. 460.

prima facie to be the true date of the making, drawing, acceptance, or indorsement as the case may be.

Sec. 12. The instrument is not invalid for the reason only that it is ante-dated, or post-dated, provided this is not done for an illegal or fraudulent purpose. The person to whom an instrument so dated is delivered acquires the title thereto as of the date of delivery.

§ **43. Value received.** The phrase "value received," or "for value received," so frequently inserted in promissory notes is not essential, and adds nothing to the force and effect of the instrument (109).

§ **44. Bills and notes defined.** A recapitulation of the formal requisites of a bill and of a note in definitions would give us the following:

"A bill of exchange is an unconditional order in writing addressed by one person to another, signed by the person giving it, requiring the person to whom it is addressed to pay on demand or at a fixed or determinable future time a sum certain in money to order, or to bearer" (110).

"A negotiable promissory note is an unconditional promise in writing made by one person to another, signed by the maker, engaging to pay on demand, or at a fixed or determinable future time, a sum certain in money to order, or to bearer" (111).

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(109) Neg. Inst. Law, sec. 6 (2).
(110) N. I. L., sec. 126.
(111) N. I. L., sec. 184.

CHAPTER III.

INCEPTION. CONSIDERATION. ACCEPTANCE.

SECTION 1. INCEPTION OF INSTRUMENT AS AN OBLIGATION.

§ 45. **Intentional signing.** An instrument in every formal respect a completed promissory note or bill of exchange is of no legal effect, unless the maker or drawer signed the paper intending to sign a bill or note. Thus, in Walker v. Ebert (1), the defendant, a German unable to read and write English, was induced by the payees to sign an instrument, in form a promissory note, in reliance upon their false statements that it was a contract appointing the defendant agent to sell a patent right. The payees sold the instrument to the plaintiff, who knew nothing of the fraud. It was held that the defendant was not liable. The instrument, although complete in form, was not the defendant's note and the plaintiff acquired nothing by his purchase of the paper.

§ 46. **Signing without reading: Carelessness.** In such a case, however, the defendant may have been so careless in affixing his signature to a paper, of the contents of which he is ignorant, that it would be unjust to allow him to escape liability to the innocent purchaser. When this is true, the courts refuse to allow the apparent maker the

(1) 29 Wis. 194.

defence that he did not intentionally sign the note in question. Thus, in Chapman v. Rose (2), the defendant signed a document in form a promissory note for $270 payable to Miller, or bearer. The defendant, misled by the false statements of Miller, supposed he was signing the duplicate of an order for farm machinery, the original of which he had delivered to Miller a few moments before. The paper having passed into the hands of an innocent purchaser, it was held that the defendant was liable upon it. The court deemed the conduct of the defendant so careless, in signing without reading when he might have done so, that it was unjust to allow him to set up the defence that he did not intentionally sign a note.

§ 47. **Carelessness a question of fact.** The question, however, whether the defendant has been careless is one of fact about which courts and juries may differ, although there may be no dispute as to the rule of law. In Lewis v. Clay (3), Clay affixed his signature to instruments in the form of notes for upwards of $55,000 under the following circumstances: Lord Neville, whom the defendant had known intimately for some years, requested the defendant, soon after he became of age, to sign certain documents as witness of Neville's signature thereto. The face of the documents was covered with blotting paper, with holes clipped out leaving places for the defendant's signatures. Neville told the defendant that the documents related to family affairs of a private nature, the contents of which he would prefer the defendant not to see. The

(2) 56 N. Y. 137.
(3) 67 Law Jour., Queen's Bench, 224.

defendant, believing the statements of Neville, signed his name through the openings in the blotting paper. It was held that the defendant was not liable to an innocent purchaser of the documents. They were not the defendant's notes, nor did the court consider the defendant's conduct was such as to make it unjust for him to set up that he never intended to sign the notes.

§ 48. **Intentional signing induced by fraud.** The class of cases we have been discussing should be carefully distinguished from cases where the maker intended to make and sign the note upon which he is sued, but would not have intended to sign had he known the true facts. In Miller v. Finley (4), the defendant was induced to sign a note for the price of a worthless patent right, which was fraudulently represented by the payee to be a valuable invention. The payee sold the note to the plaintiff, who knew nothing of the fraud practiced upon the defendant. It was held that the defendant was liable. His intention to sign the note in dispute was unquestioned. He would not have signed had he known that the patent was valueless, but he did not know that fact and in consequence intended to sign. Of course, in such a case the payee who practiced the fraud could not recover upon the instrument, for the reason that it would be unjust to allow him to enforce the obligation and retain the proceeds, but not because the note was not a valid negotiable instrument.

§ 49. **"Delivery."** In addition to the intentional signing of the instrument, something further is necessary to give it an inception as an obligation. In order that the

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(4) 26 Mich. 249.

bill or note may have legal effect, it must have passed out of the possession of the maker or drawer. A note found among the maker's papers after his death imposes no obligation upon him or his estate. But, if in any manner a completed instrument passes out of the possession of the signer into that of the payee or bearer, the instrument imposes a legal obligation on the maker or drawer. The mere involuntary parting with possession gives the instrument its inception as a bill or note. The inception of the instrument may thus result from a theft or forcible taking by the payee or bearer from the signer, or from fraud or duress practiced by the former upon the latter, as well as from an intentional delivery by the maker or drawer.

§ 50. **Position of fraudulent payee or bearer.** The payee or bearer, who has secured possession of the instrument by theft, fraud, duress, or under such circumstances, that, to his knowledge, the maker does not intend the instrument to operate for the payee's benefit, is not permitted personally to enforce it. This is not because the stolen instrument is not the obligation of the signer, but because the payee, in view of the manner in which he secured the instrument is compelled on obvious grounds of justice to hold it, or its proceeds, for the defrauded signer. It would be profitless to permit the thief to sue the maker on the note, when the maker himself is entitled to recover from the thief either the instrument or any money which the thief has received upon it.

§ 51. **Position of payee in case of conditional delivery.**

Similarly, if the maker or drawer deliver the instrument to the payee, upon condition that it shall not be enforced except upon the happening of a certain contingency, it is not enforceable by the payee until the condition is fulfilled. Thus, in McFarland v. Sikes (5), the defendant had delivered a promissory note for $300, payable to the plaintiff, upon condition that the instrument was to be returned when demanded. The defendant demanded the instrument, but the plaintiff refused to return it and brought action on the note. It was held that the plaintiff could not recover. The real reason for the decision is that were the plaintiff allowed to recover on the note, the defendant could turn about and recover from the plaintiff for breach of his contract to return the note on demand. The parties would then be, after two actions, in the same position as if no recovery had been allowed in the first instance.

That the reason why a payee or bearer cannot recover, if he has obtained possession of a bill or note from the maker or drawer by theft, or fraud, or duress, or upon condition that he will not enforce it, is the one suggested, and not that the instrument has not had an inception, is made clear by the cases discussed below. In those cases, had the paper not been the existing obligation of the maker or drawer in the thief's hands, the thief's transfer to the plaintiff would have vested no right against the maker or drawer in the plaintiff; and the case would be like the sale of a stolen watch which vests no rights in the purchaser.

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(5) 54 Conn. 250.

§ 52. **Position of innocent purchaser of the instrument.** If the thief, or fraudulent payee, or the payee who holds the note subject to a condition, sells the instrument to a purchaser who knows nothing of the wrong of the payee, the purchaser is entitled to recover upon the instrument from the maker. Thus, in Shipley v. Carroll (6) it appeared that the defendant made and signed the note in suit as a matter of amusement, with no design of delivering it to the payee, and that the payee stole the note from the maker and sold it to the plaintiff, who had no notice of the theft. It was held that the note was an obligation of the maker's, and that the plaintiff who bought the note innocently was guilty of no wrong, or breach of duty, or injustice in enforcing it. In Clark v. Johnson (7), the same rule was applied. In that case the maker, who had signed a note complete in form, was about to insert a condition in it before delivery, when the payee snatched the note from the maker's hands, made off with it, and sold it to the plaintiff, an innocent purchaser. The maker was held liable. The same result has been reached under the N. I. L. (8) which provides as follows:

Sec. 16. Every contract on a negotiable instrument is incomplete and revocable until delivery of the instrument for the purpose of giving effect thereto. As between immediate parties, and as regards a remote party other than a holder in due course, the delivery, in order to be ef-

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(6) 45 Ill. 285.
(7) 54 Ill. 296.
(8) Greeser v. Sugarman, 76 N. Y. Supp. 922; Massachusetts Bank v. Snow, 187 Mass. 159.

fectual, must be made either by or under the authority of the party making, drawing, accepting, or indorsing, as the case may be; and in such case the delivery may be shown to have been conditional, or for a special purpose only, and not for the purpose of transferring the property in the instrument. But where the instrument is in the hands of a holder in due course, a valid delivery thereof by all parties prior to him so as to make them liable to him is conclusively presumed.

§ 53. **Incomplete instruments.** If a person signs a promissory note or bill of exchange incomplete in some particular, as, for example, the amount or date of payment; or a blank printed form for a note or bill; or puts his signature on a piece of paper wholly blank; and delivers it to another with authority to fill in the blank or blanks, so as to make a complete instrument, the signer is bound on the bill or note if the blanks are filled in in accordance with his authority by any holder, exactly as he would have been had he himself filled up the blanks before delivery. Furthermore, the signer of the incomplete instrument is assumed to have authorized any holder to fill in the blanks in any manner he desires, and, in an action against the signer upon the instrument, he must prove that the authority he gave has actually been exceeded if that is the fact. In the words of the N. I. L. (9):

"When the instrument is wanting in any material particular, the person in possession thereof has a prima facie authority to complete it by filling up the blanks therein.

(9) Sec. 14.

And a signature on a blank paper, delivered by the person making the signature in order that the paper may be converted into a negotiable instrument, operates as a prima facie authority to fill it up for any amount. In order, however, that any such instrument, when completed, may be enforced . . . it must be filled up strictly in accordance with the authority given and within a reasonable time."

For example, in Cruchley v. Clarance (10), the defendant drew a bill on M, payable "to the order of ————," and delivered it to Vashon, who transferred it to the plaintiff. The plaintiff inserted his own name in the instrument as payee and sued the defendant. It was held that the plaintiff must be assumed to have authority to fill in the blank as he saw fit, the defendant not having shown that he had limited Vashon's authority in respect to the filling of the blank; and the plaintiff prevailed. An illustration of the other aspect of this rule is Awde v. Dixon (11). In that case the defendant signed a note, blank as to date and payee, and delivered it to his brother, authorizing him to fill the blanks and negotiate it after one Robinson had signed the note as co-maker with the defendant. Without securing Robinson's signature, the brother took the note to the plaintiff, who bought it in good faith and filled in the date and his own name as payee. It was held that the plaintiff could not recover. It appearing that the defendant had authorized the filling of the blanks, only in the event of Robinson's signing, the presumption of au-

(10) 2 Maule & S. 90.
(11) 6 Exch. 869.

thority arising from possession of the note with unfilled blanks was rebutted (12).

§ 54. **Innocent purchaser of instrument completed in excess of authority.** Suppose, however, that the plaintiff had purchased the notes from the brother, after he had, in breach of his authority, filled the blanks; and that the plaintiff had no knowledge that the note was not complete when signed by defendant. In such a case the plaintiff could recover (13). The violation of his authority by the defendant's agent would be no reason for defeating a purchaser in good faith of the completed note. The N. I. L. (14) states the rule as follows:

"But if any such instrument, *after completion,* is negotiated to a holder in due course, it is valid and effectual for all purposes in his hands, and he may enforce it as if it had been filled up strictly in accordance with the authority given and within a reasonable time."

§ 55. **Incomplete instruments not intentionally delivered as such.** Up to this point, we have been dealing with blank pieces of paper and incomplete notes and bills, which have been signed and delivered by the signers "in order that the paper may be converted into a negotiable instrument." If the signer of a blank sheet of paper intended it for some other purpose, or if the signer of an incomplete note never intrusted any one with the paper for that purpose, the signer is not chargeable upon the paper,

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(12) See also, to the same effect, Boston Steel Co. v. Steuer, 183 Mass. 140.

(13) Putnam v. Sullivan, 4 Mass. 45.

(14) Sec. 14.

even though after its completion it was transferred to an innocent purchaser. In Caulkins v. Whistler (15), the defendant was employed by Smith as agent to sell farm machinery. At Smith's request defendant signed his name upon a blank piece of paper, which Smith was to send to the manufacturers of the machinery, so that they might know defendant's signature upon the orders he sent in. The note upon which the action was brought was printed over defendant's signature. The defendant was not liable. In another case, the defendant wrote his signature as acceptor on several printed blank forms for bills of exchange, and left them in a drawer of his desk. The blanks were stolen, filled up, and negotiated to the plaintiff, an innocent purchaser. It was held the plaintiff could not recover (16). The N. I. L. (17) thus codifies the result of these cases:

"Where an incomplete instrument has not been delivered, it will not, if completed and negotiated without authority, be a valid contract in the hands of any holder."

§ 56. **Presumption of delivery.** That a negotiable instrument has not had a valid inception is a fact which must be proved in the first instance by the defendant who is sued upon it. In other words, from the mere production in court by the plaintiff of a completed instrument signed by the defendant, it is inferred, as a matter of fact, that the instrument produced is the obligation of the signer.

(15) 29 Ia. 495.
(16) Baxendale v. Bennett, 3 Q. B. Div. 525.
(17) Sec. 15.

"Where the instrument is no longer in the possession of a party whose signature appears thereon, a valid and intentional delivery by him is presumed until the contrary is proved" (18).

SECTION 2. CONSIDERATION.

§ 57. **What a consideration is.** A simple promise is unenforceable in law. If A, intending to benefit B, promises to pay him $100, B can not compel A to pay. But if a consideration moved from B to A for the promise, there would be a valid contract and A's promise would be binding. A consideration is a surrender of a legal right or a promise to surrender a legal right. Thus, if B had paid A $100, or delivered property to him, or turned hand springs for A's amusement, or had promised to do any of those acts in exchange for A's promise to pay $100, B could hold A to the performance of his promise. The doctrine of consideration is discussed at length in Contracts, §§ 40-61, in Volume II of this work.

§ 58. **Consideration necessary for negotiable instrument.** The doctrine of consideration was of pure common law origin, and it is probable that originally it had no place in the law of bills and notes, which has its roots in the law merchant. Thus, if A made a promissory note payable to B, and delivered it to the payee as a gift, it was once held that B could enforce the note (19). But the common law courts, failing to distinguish between common law contract obligations and bills and notes, have at-

(18) Neg. Inst. Law, sec. 16.
(19) 2 Bl. Com. 445, 446; Bowers v. Hurd, 10 Mass. 427.

tempted to apply the doctrine of consideration to negotiable instruments. Forced constructions of simple business transactions, and arbitrary distinctions have been the result. Nevertheless the N. I. L. enacts (20) that "absence . . . of consideration is a matter of defence." As a result, in the case supposed of the gift by A of his note to B, the absence of consideration would be a defence to A (21). Again, if B, the payee of a note for which he had given a consideration to the maker, indorsed the note to C as a gift, C could not enforce B's contract as indorser against him, because no consideration was given by C (22).

§ 59. **Pre-existing debt as consideration.** The N. I. L. declares (23) that "any consideration sufficient to support a simple contract" may be consideration for a negotiable instrument. We are thus thrown back upon our common law definition of consideration, as a surrender of a legal right, or a promise to surrender a legal right.

If A owes B $100 and B accepts, in satisfaction and discharge of the debt, A's note for that amount, the surrender by B of the old debt in exchange for the note is the surrender of a legal right and a consideration for the note (24). For the same reason, if B had accepted X's note in payment of A's debt to B, the surrender by B of A's debt would be a consideration for X's note (25). In both of these cases B's original claim against A has been absolutely discharged, and his only rights are upon the

(20) Sec. 28.
(21) Starr v. Starr, 9 Oh. St. 75.
(22) Easton v. Pratchett, 1 Crompton, M. & R. 798.
(23) Sec. 25.
(24) Union Bank v. Jefferson, 101 Wis. 452.
(25) Petrie v. Miller, 67 N. Y. Supp. 1042; 173 N. Y. 596.

instrument. Thus, in the second case B could look to X only for payment. It is held, however, that unless the parties expressly agree that the note shall extinguish the debt for which it was given, it does not have that effect, and that, if the note is not paid, B, the creditor, may sue A on the original debt (26). If then, B accepts X's note on account of, but not in discharge of, a debt due from A, is there any consideration for the instrument? What legal right has B surrendered or promised to surrender? In such a case it is held that from B's acceptance of the note on account of the debt is "implied" a promise on his part not to sue A until after the note becomes payable. Thus, if the note were payable three months after date, B's "implied" promise not to sue A on the debt for three months is said to be the consideration of the note (27). The same result is attained by the same reasoning, where B accepts A's, the debtor's, own note, payable after date, on account of A's debt (28). It is true in these cases that B, after accepting the note for the debt, can not sue A until the note has become due. But the reason for this is not that B has impliedly promised not to sue, but the rule of law that the acceptance of a negotiable instrument for a debt is conditional payment and ipso facto suspends the debt (29).

§ 60. **Same (continued).** Suppose, however, the bill or note taken on account of the debt is payable on demand. In such a case the note would be due at once, and, if not

(26) Ward v. Evans, 2 Ld. Raymond, 928.
(27) Thompson v. Gray, 63 Me. 228.
(28) Baker v. Walker, 14 M. & W. 465.
(29) Ward v. Evans, 2 Ld. Raymond, 928; Martens-Turner Co. v. Mackintosh, 17 N. Y. App. Div. 419.

paid forthwith, B might immediately bring an action against A on the original debt. Is there any implied promise on the part of the creditor who takes such an instrument not to sue his debtor? It seems there is not, and yet the courts hold that the instrument is binding, whether it be the note of the debtor himself or a third person (30). The result of all these decisions is summed up in the N. I. L. as follows (31):

"An antecedent or pre-existing debt constitutes" consideration; "and is deemed such whether the instrument is payable on demand or at a future time."

The real explanation of the cases, holding a note taken on account of a debt to be binding, is that no consideration is necessary for a bill or note. But the courts and the N. I. L. first force the common law requirement of consideration upon negotiable instruments, and then give a fanciful interpretation to simple business transactions in order to comply with it. Another and more striking instance, where an obligation on a negotiable instrument is held binding without a consideration, although the courts and N. I. L. profess to require one, is the case where A, being indebted to C, draws a bill of exchange on B, who is under no obligation whatever to A, ordering B to pay $100 to C. A delivers the bill to the payee. Upon presentation by C of the order to B, he, as an act of friendship or business accommodation, "accepts," i. e., promises to pay the in-

(30) Childs v. Monins, 2 Broderip & B., 450; Sison v. Kidman, 3 Manning & Gr. 810. But see Strong v. Sheffield, 144 N. Y. 392, for an exception to this rule in New York and some other states.

(31) Sec. 25.

strument. Clearly in this case neither A nor C has surrendered or promised to surrender any legal right, yet it is well settled law that B is liable on his acceptance (32).

§ 61. **Examples of consideration.** Of course, wherever, as in the case of an instrument accepted in absolute extinguishment of an existing debt, there really is a consideration for the maker's, or indorser's, or acceptor's promise, viewed as a simple common law promise, the instrument is enforceable. Thus, where the creditor receiving a negotiable instrument in fact promises to refrain from suing on the debt until the instrument matures, or, at the request of the debtor, actually refrains from suit, the instrument is binding (33). Or, if A loans money to B and takes B's note or a third party's note as collateral security for the loan, the advance of money by A is a consideration for the note of either B or X (34). Or, if A holds B's note as collateral security for B's debt, A's surrender of the note in exchange for X's note substituted as collateral security for the debt, is a consideration for X's note (35). Or, if A gives his note to B in exchange for B's note to A, the giving of each note is a consideration for the other (36).

§ 62. **Moral consideration.** As the N. I. L. says that any consideration sufficient to support a simple contract may be the consideration for a negotiable instrument, we find

(32) Commercial Bank v. Norton, 1 Hill, 501.

(33) Mansfield v. Corbin, 2 Cush. 151; Russell v. Bassett, 79 Conn. 709.

(34) Black v. Bank, 96 Md. 399; Metropolitan Co. v. Springer, 90 N. Y. Supp. 376; Mersick v. Alderman, 77 Conn. 634.

(35) Allentown Bank v. Clay Co., 217 Pa. 128.

(36) Milius v. Kaufman, 93 N. Y. Supp. 669.

the anomalous doctrine of "moral consideration" recognized in the law of negotiable instruments. So, if A gives his note to B for a debt which is barred by the statute of limitations, or by A's discharge in bankruptcy, or voidable on the ground of A's infancy or insanity, A's note is enforced against him on the same theory as his simple promise to pay would be in such cases (37). See Contracts, §§ 58-60, in Volume II of this work.

§ 63. **Presumption of consideration.** Although a consideration is necessary for a negotiable instrument, the plaintiff in an action on a bill or note does not need to prove that he gave one. Absence of consideration is a "matter of defense" which the defendant must prove in order to defeat the action.

"Every negotiable instrument is deemed prima facie to have been issued for a valuable consideration; and every person whose signature appears thereon to have become a party thereto for value" (38).

Section 3. Acceptance of Bills.

§ 64. **Drawee not bound unless he accepts.** If A, complying with the requirements as to form, draws a bill of exchange on B, payable to C, and delivers it to the payee, the act of A in drawing and delivering the instrument imposes no liability on the drawee, B. If B is not indebted to A this is obvious. If B is indebted to A, B's duty to pay runs to A, and A cannot impose on B a new duty, i. e., one

(37) Mill v. Van Trees, 50 Cal. 547; Wislizenus v. O'Fallon, 91 Mo. 184; Bank v. Sneed, 97 Tenn. 120.

(38) Neg. Inst. Law, sec. 24.

to pay to a third person, C. But A can assign his claim to C, thereby empowering C to collect the debt. Does the bill operate as an assignment? This is a question of A's intention, and the form of the bill which is an unconditional order to pay a definite sum of money certainly seems to preclude its interpretation as an assignment, i. e., an authority to collect the sum, if any, due from the debtor. Thus the N. I. L. provides:

Sec. 127. A bill of itself does not operate as an assignment of the funds in the hands of the drawee available for the payment thereof, and the drawee is not liable on the bill unless and until he accepts the same.

It is the formal act of acceptance of a bill by the drawee from which his obligation to pay arises.

§ 65. Form of acceptance. Oral acceptance.

"The acceptance of a bill is the signification by the drawee of his assent to the order of the drawer. The acceptance must be in writing and signed by the drawee" (39).

An oral acceptance is not binding under the statute

§ 66. Acceptance written on the bill. The normal and proper mode of acceptance is one written on the bill itself. Any words written on the face or back of the instrument signifying the drawer's assent to the order are sufficient, provided they are coupled with the drawer's signature. For example, "Accepted," "Presented," "Seen,"

(39) Neg. Inst. Law, sec. 132.

"Payable at X Bank," or an order by the drawee on his agent to pay, preceded or followed by the drawer's signature, are good forms of acceptance. So also is the signature of the drawee without more, on the theory that the holder is authorized to write an acceptance over the signature (40). An acceptance written on the bill, however, does not impose an obligation on the acceptor until he has re-delivered the bill to the holder, or notified him of the fact of acceptance. " 'Acceptance' means an acceptance completed by delivery or notification" (41).

§ 67. **Extrinsic written acceptance.** Although the N. I. L. requires the acceptance to be in writing, thereby depriving an oral acceptance of validity, the acceptance to be binding need not be written on the bill. For example, an acceptance by telegraph is sufficient, if the message is filed or delivered in writing (42). But an extrinsic written acceptance is peculiar.

"Where an acceptance is written on a paper other than the bill itself, it does not bind the acceptor, except in favor of a person to whom it is shown, and who, on the faith thereof, receives the bill for value" (43).

In consequence, if the purchaser of a bill of exchange which had been accepted by telegraph did not take it in reliance upon the written message, he would have no action against the drawee.

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(40) Spear v. Pratt, 2 Hill, 582.
(41) Neg. Inst. Law, sec. 191.
(42) Eakin v. Bank, 67 Kan. 338.
(43) Neg. Inst. Law, sec. 134.

§ 68. **Virtual acceptance.** An acceptance presupposes an existing bill, but the prospective drawee may make a contract with the drawer to accept a bill to be drawn. Such a contract, whether oral or in writing, is perfectly valid. In fact, that is the very contract which a bank makes with its customers upon receiving their deposits, i. e., to pay their checks. But it is a contract which gives the payee or holder no rights, because he is not a party to it, although of course the drawer to whom the promise was made could sue and recover his damages, if any, in case the drawer refused to accept the bill when drawn. This view of the law, which gave the payee no rights against the drawee even when he took the bill knowing of the drawee's promise to pay it when drawn, was questioned in a series of decisions, which ultimately established the anomalous doctrine of so-called "virtual acceptances," which is stated in the N. I. L. (44) as follows:

"An unconditional promise in writing to accept a bill, before it is drawn, is deemed an actual acceptance in favor of every person who, upon the faith thereof, receives the bill for value."

It is to be noted that the promise, to operate as a virtual acceptance, must be unconditional and in writing, and that no holder can charge the drawee upon his unconditional written promise, unless he paid value for the instrument in reliance upon it.

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(44) Sec. 135.

§ 69. **Constructive acceptance.** When a bill is presented to a drawee for acceptance,

"the drawee is allowed twenty-four hours after presentment in which to decide whether or not he will accept the bill; but the acceptance, if given, dates as of the day of presentation" (45).

The holder may give the drawee additional time, if he sees fit, to come to a decision. During the interval, whether of twenty-four hours or longer, between the presentment for acceptance and the acceptance or refusal to accept, the bill may be in the possession of the holder or the drawee. If the holder retains the bill, no difficulties arise. If, at the end of twenty-four hours or such period as the holder may allow, the bill is not accepted, the holder may treat it as dishonored by non-acceptance. If, however, the bill is left in the possession of the drawee when first presented for acceptance, the drawee, instead of returning it accepted or not accepted, may keep or destroy it. His retention may be with or without the holder's consent. If he keeps it with the consent of the holder, no legal consequences flow from the retention, even though with the surrounding circumstances it indicates an intention to accept. For, no matter how clear the intention to accept is, it is ineffectual because not "in writing and signed by the drawee" (46).

If the drawee retains or destroys the bill, without the holder's consent, it is clear that the holder may bring an

(45) Neg. Inst. Law, sec. 136.

(46) Neg. Inst. Law, sec. 132; Dickinson v. Marsh, 57 Mo. App. 566. But see Wisner v. Bank, 220 Pa. St. 21; State Bank v. Weiss, 91 N. Y. Supp. 276.

action to recover the instrument or its value (47). But the N. I. L. gives him extraordinary relief. He may treat the bill as accepted:

Sec. 137. Where a drawee to whom a bill is delivered for acceptance destroys the same, or refuses within twenty-four hours after such delivery, or within such other period as the holder may allow, to return the bill accepted or non-accepted to the holder, he will be deemed to have accepted the same.

This kind of acceptance by non-acceptance may well be termed a "constructive acceptance."

§ 70. Kinds of acceptance.

"An acceptance is either general or qualified. A general acceptance assents without qualification to the order of the drawer. A qualified acceptance in express terms varies the effect of the bill as drawn" (48).

A "virtual acceptance" can not be a qualified acceptance, because it is an unconditional promise to accept a bill complying with its terms. If the bill, when drawn, does not come within the terms of the promise, it is not "virtually accepted." For obvious reasons also a constructive acceptance is always a general acceptance. But an acceptance on the bill or in a separate document may be qualified.

§ 71. Qualified acceptance.

Sec. 141. An acceptance is qualified, which is:

(47) Jeune v. Ward, 1 B. & Ald. 653.
(48) Neg. Inst. Law, sec. 139.

1. Conditional, that is to say, which makes payment by the acceptor dependent on the fulfillment of a condition therein stated;

2. Partial, that is to say, an acceptance to pay part only of the amount for which the bill is drawn;

3. Local, that is to say, an acceptance to pay only at a particular place;

4. Qualified as to time;

5. The acceptance of some one or more of the drawees, but not of all.

§ 72. **Conditional acceptance.** Qualified acceptances are binding upon the acceptor, subject to the qualification. For example, A drew a bill on B, a commission merchant, to cover the value of goods shipped to B to be sold by him. B accepted by a promise to pay when the goods were sold. It was held that B was bound by his conditional acceptance to pay the bill when the goods were sold (49).

§ 73. **Partial acceptance.** "I do accept this bill, to be paid half in money and half in bills" is a partial acceptance, which binds the acceptor to pay half of the bill (50). The promise to discharge half of the order "in bills" is not even a qualified assent to the order of the bill to pay *money,* and is therefore ineffective as an acceptance.

§ 74. **Local acceptance.** A bill ordering A to pay B $100, accepted by A's promise to pay it at a particular place, e. g., at the First National Bank, does not have to be presented at the place specified in order to hold the

(49) Smith v. Abbot, 2 Strange, 1152.
(50) Petit v. Benson, Comberbach, 452.

acceptor. In other words, the obligation of the acceptor, notwithstanding its terms, is held not to be conditional upon its presentment at the place named for payment (51). In consequence, such an acceptance "assents without qualification to the order of the drawer," and is a general acceptance (52). But, if B accepted by promising to pay at the First National Bank *only,* he would be under no duty to pay unless the bill was there presented for payment, i. e., his obligation to pay would be conditional, and would not be an unqualified assent to the order. Such an acceptance is a "local" acceptance, and is binding according to its terms.

§ 75. **Acceptance qualified as to time.** If the drawee promises to pay at a time other than that designated in the bill, the acceptance is "qualified as to time," and binds the acceptor. Thus, if a bill payable Jan. 1, 1910, is presented to the drawee, and he promises to pay it Feb. 1, 1910, he is bound by his acceptance to pay on Feb. 1 (53).

§ 76. **Acceptance by less than all of drawees.** If the bill is drawn on several jointly, a promise by less than all to pay is not an unqualified assent to the order which directs all to pay. The promise, however, is treated as a qualified acceptance binding on the drawees who make it. The usual example of this rule is the unauthorized acceptance by a partner of a bill drawn on the firm. Since the acceptance is without authority, the other members

(51) Halstead v. Skelton, 5 Q. B. 86.

(52) Neg. Inst. Law, sec. 139.

(53) Walker v. Atwood, 11 Modern, 190.

of the firm are not bound, but the partner who wrote the acceptance is held (54).

§ 77. **Acceptance by person not drawee.** If a person not designated in the bill as drawee attempts to accept it, the attempt results neither in a general nor in a qualified acceptance, and the would be acceptor does not become liable as such (55). No one except the designated drawee can accept a bill (56).

§ 78. **Holder may require an unqualified acceptance written on bill.** Although extrinsic written acceptances, virtual acceptances, constructive acceptances, and qualified acceptances are enforceable, the holder is entitled to have a general acceptance written on the bill itself. If this is refused, and an extrinsic written acceptance or a qualified acceptance is offered, the holder may treat the refusal as an absolute refusal to accept, and proceed accordingly. The N. I. L. provides:

Sec. 133. The holder of a bill presenting the same for acceptance may require that the acceptance be written on the bill, and, if such request is refused, may treat the bill as dishonored.

Sec. 142. The holder may refuse to take a qualified acceptance, and if he does not obtain an unqualified acceptance, he may treat the bill as dishonored by non-acceptance.

§ 79. **Effect of taking qualified acceptance.**

"When a qualified acceptance is taken, the drawer and

(54) Owen v. Van Ulster, 20 L. J. C. P. 61.
(55) As to acceptors for honor, see Neg. Inst. Law, secs. 161-170.
(56) Davis v. Clark, 6 Q. B. 16.

indorsers are discharged from liability on the bill, unless they have expressly or impliedly authorized the holder to take a qualified acceptance, or subsequently assent thereto" (57).

For example, if A draws a bill on B, payable to C, who indorses and transfers the bill to D, and D takes a qualified acceptance from B without the assent of A and C, they are discharged and D must thereafter look to D alone for payment. But

"When the drawer or indorser receives notice of a qualified acceptance, he must, within a reasonable time, express his dissent to the holder, or he will be deemed to have assented thereto" (58).

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(57) Neg. Inst. Law, sec. 142.
(58) Neg. Inst. Law, sec. 142.

CHAPTER IV.

NEGOTIATION.

§ 80. **Transfer generally.** The payee or bearer of a negotiable instrument may either hold the instrument and collect it at maturity, or he may negotiate, i. e., transfer it to another. The instrument, "if payable to bearer is negotiated by delivery; if payable to order it is negotiated by the indorsement of the holder" (1). Or, the instrument may be transferred by operation of law, for example, by the death of the payee or bearer, in which event it becomes the property of his executor or administrator; or by his bankruptcy, when it passes to his trustee in bankruptcy.

§ 81. **Who may negotiate.** Furthermore, the transferee of the payee or first bearer may negotiate the instrument. The rule then is that any owner of a bill or note may negotiate it. In Stone v. Rawlinson (2) the defendants made a note payable to Watson, or order. Watson died, and his administrators indorsed the note to the plaintiff. It was objected that the administrator's indorsement did not transfer the note to the plaintiff. But the court held that the plaintiff could recover, saying: "Whoever has the absolute property in a bill . . .

(1) Neg. Inst. Law, sec. 30.
(2) Willes, 559.

may assign it as he pleases." But all of the payees or indorsers, i. e., all the owners must join in the transfer.

Sec. 41. Where an instrument is payable to the order of two or more payees or indorsees who are not partners, all must indorse, unless the one indorsing has authority to indorse for the others (3).

Thus, if a note, payable to A and B, is indorsed by A in the names of A and B, without authority from B, and delivered to the plaintiff, the transfer, not being the act of both owners, does not pass title to the plaintiff (4). Again, an indorsement of a note payable to a firm, by one partner in his own name, even if authorized by the other partners, does not transfer the instrument, because the indorsement is not that of all the owners (5).

§ 82. **Transfer by delivery.** A bill or note payable to bearer is transferred by delivery without indorsement (6). Delivery may be voluntary, or it may be involuntary as in the case of theft.

A voluntary delivery may be intended as a sale or gift to the transferee, or the transfer may be for the purpose of enabling the transferee to collect the instrument for the transferor. Whatever the intention, the delivery passes title, makes the transferee the owner, and, as a consequence, entitled to bring an action on the instrument and collect the proceeds. What the transferee does with the proceeds after their receipt by him does not affect the

(3) Neg. Inst. Law, sec. 41.
(4) Kaufman v. Bank, 151 Mich. 65.
(5) Estabrook v. Smith, 6 Gray, 570 (Mass.).
(6) Neg. Inst. Law, sec. 30.

question. If the transfer was a gift or sale, he, of course, keeps them for himself; if it was simply for the purpose of collection, he holds them for his transferor. But in any event his rights on the instrument are complete and absolute. The effect of the delivery of a bearer instrument is illustrated by two cases. In the first, Mrs. Remsen was the holder of a note payable to bearer made by the defendant. Mrs. Remsen was indebted to the defendant, and, had she sued him on the note, he might have set off the amount she owed him against the amount due on the note. But she delivered the note to her agent, the plaintiff, for the purpose of having the action brought by him. It was held that the plaintiff had become the owner of the note by the delivery and could maintain an action as such, and the defendant was not allowed to set off his debt, because it was not due from the plaintiff who was now the owner (7). In the second case, the Rev. Dr. Walker was the holder of a bill payable to bearer. Wishing to obtain the money due on the bill, but unwilling that his name should appear as plaintiff in an action at law, he requested the plaintiff to bring an action on the bill for him. The bill was not delivered to the plaintiff. It was held that the plaintiff was not the owner of the instrument and was not entitled to sue upon it (8).

An involuntary, as well as a voluntary delivery passes title; but, as we have seen (9) the character of the delivery makes it unconscientious for the thief, for example,

(7) Mauran v. Lamb, 7 Cowen, 174 (N. Y.).

(8) Emmett v. Tottenham, 8 Ex. 884.

(9) See § 6, above.

to enforce his rights on the instrument, although an innocent purchaser from him may do so (10).

§ 83. **Form of indorsement.** The mode of transfering a bill or note payable to order is by indorsement. The formal requirements with which an indorsement must comply to be effective are: (1) that it be in writing on the instrument; (2) that it be an order to pay the transferee; (3) that the order direct the payment to the transferee of the whole sum due on the instrument; and (4) that the instrument with the indorsement upon it be "delivered" to the transferee.

§ 84. **Indorsement must be in writing on the instrument.** A delivery of a note payable to order, coupled with an oral promise by the holder to be responsible as indorser, or to indorse in the future, does not transfer the note (11). Nor would a letter to the transferee, promising to be responsible as indorser and to indorse as soon as possible, be effective as an indorsement (12). But an indorsement written on an *allonge*, or piece of paper attached to the instrument for the purpose of bearing indorsements, is sufficient (13). If the indorsement is written on the instrument, it does not affect its validity that it is written on the face of the paper, notwithstanding the meaning of the word "indorse" and the almost universal usage of writing the order on the back (14). The N. I. L. provides in general terms that:

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(10) Hays v. Hathorn, 74 N. Y. 486.
(11) See Moxon v. Pulling, 4 Campbell, 50.
(12) Wilmington Bank v. Houston, 1 Harrington, 225 (Del.).
(13) Folger v. Chase, 18 Pick. 63 (Mass.).
(14) Herring v. Woodhull, 29 Ill. 92.

"The indorsement must be written on the instrument or upon a paper attached thereto" (15); and "Where a signature is so placed upon the instrument that it is not clear in what capacity the person making the same intended to sign, he is deemed an indorser" (16).

§ 85. **Indorsement must be an order to pay.** The ordinary indorsement complies in terms with this requirement. For example, "Pay to X (Sgd.) B," indorsed on a note made payable to B by A, is an order upon the maker, A, to pay X the amount of the note at its maturity. Anything less than an order, i. e., an imperative direction, is not an indorsement. Thus, the delivery of a note payable to order, with the following guaranty of payment written thereon, was held not to transfer the note (17):

"For value received, we hereby guarantee the payment of the within note at maturity, or at any time thereafter, with interest at ten per cent. per annum until paid, and agree to pay all costs and expenses paid or incurred in collecting the same. B. F. Allen, Pres't."

"I assign the within note," or "I assign all my right, title and interest in and to the within note," is not an indorsement (18). An assignment is an authority to the assignor to collect; an order is a direction to the maker to pay. This distinction has been overlooked by many courts in recent decisions, and both guaranties and assign-

(15) Neg. Inst. Law, sec. 31.
(16) Neg. Inst. Law, sec. 17 (6).
(17) Trust Co. v. Bank, 101 U. S. 68.
(18) Hatch v. Barrett, 34 Kan. 223.

ments written on negotiable instruments have been held to transfer them as indorsements (19).

§ 86. **Indorsement must be an order to pay the whole sum due on instrument.** If the holder attempt to split up the maker's or acceptor's obligation by directing payment of part of the sum due to one transferee, and the payment of another part to a second, the attempt is futile, is not an indorsement, and does not transfer the instrument to either (20). Even if partial "indorsements" which together cover the entire sum due, are made to the same person at different times, the instrument is not transferred (21). Of course there is no objection to indorsing a bill or note, after part of the sum due has been paid. Such an indorsement orders the payment of the whole sum due on the instrument at the time the indorsement is made. An indorsement ordering payment of a bill or note to A and B jointly is not a partial indorsement of one-half to each, for the two as a group are entitled under the order to the whole sum, but neither separately is entitled to anything. An indorsement ordering payment of the whole sum to A and also to B is manifestly contradictory in its terms, and is neither an order to pay the whole or any part of the sum due on the instrument to either A or B. However, an indorsement "Pay to A or B" seems to be good under the section of the N. I. L. (22) authorizing an instru-

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(19) Thorp v. Windeman, 123 Wis. 149; Evans v. Freeman, 142 N. C. 61; Elgin Co. v. Zelch, 57 Minn. 487.

(20) Anonymous, 3 Salkeld, 70.

(21) Hughes v. Kiddell, 2 Bay, 324 (S. C.).

(22) Sec. 8 (5).

ment to be made payable to "one or more of several" persons. The N. I. L. provides:

Sec. 32. The indorsement must be an indorsement of the entire instrument. An indorsement, which purports to transfer to the indorsee a part only of the amount payable, or which purports to transfer the instrument to two or more indorsees severally, does not operate as a negotiation of the instrument. But where the instrument has been paid in part, it may be indorsed as to the residue.

§ 87. **Indorsement is not binding unless instrument is delivered.** "Indorsement" means an indorsement completed by "delivery" (23). "Delivery" means, as we have already seen (24), nothing more than a physical transfer of the instrument. Thus, if A, the payee of a note, write upon it, "Pay to X (Sgd.) A," and place the note in his safe, the indorsement is not complete. But, if in the night X breaks open the safe and steals the note, the indorsement is complete and effective to transfer the instrument and bind A as indorser. Although X is not allowed personally to take advantage of the legal rights he has acquired, because of the manner in which he has acquired them, an innocent purchaser of his rights may do so (25).

§ 88. **Kinds of indorsement.** The formal requirements which have been stated apply equally to the several kinds of indorsement which are recognized. The N. I. L. says:

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(23) Neg. Inst. Law, secs. 191, 30.

(24) §§ 6, 49, above.

(25) Greeser v. Sugarman, 76 N. Y. Supp. 922; Massachusetts Bank v. Snow, 187 Mass. 159.

Sec. 33. An indorsement may be either special or in blank; or it may also be either restrictive, or qualified, or conditional.

§ 89. **Special indorsements.** "A special indorsement specifies the person to whom, or to whose order, the instrument is to be payable; and the indorsement of such indorsee is necessary to the further negotiation of the instrument" (26). "Pay to X (Sgd.) A;" "Pay to X, or order (Sgd.) A;" and "Pay to the order of X (Sgd.) A;" are examples of special indorsements. Just as a note payable to A cannot be transferred without the indorsement of A, so an instrument specially indorsed by the payee, A, to X, cannot be transferred by X without his indorsement.

§ 90. **Blank indorsements.** If the payee writes his name upon the instrument without designating any transferee, the indorsement is blank, i. e., incomplete. If the instrument passes into the hands of a transferee he has an authority, implied from the delivery of the instrument with the incomplete indorsement upon it, to complete the indorsement by filling in his name or that of some other person as indorsee or transferee. If he fills in his own name, the indorsement becomes a completed special indorsement, and the legal situation is the same as if the payee had made a special indorsement to him in the first instance. Again, if he fills in the name of a third person as indorsee, upon delivery to him the person named becomes the indorsee with precisely the same results as if the payee had indorsed specially to him. However, without com-

(26) Neg. Inst. Law, sec. 34.

pleting the indorsement, the first transferee may deliver the instrument. What then are the rights of the person in possession of the instrument? They are the same as those which the first transferee had, i. e., to complete the indorsement by filling in his own or a third person's name as indorsee. The consequence is, that, as long as the payee's indorsement remains "blank," the instrument is transferable by delivery and in effect payable to bearer. But as soon as it is completed, the instrument is transferable only by the indorsement of the indorsee under the special indorsement. The N. I. L. states the law in three sentences:

"The signature of the indorser, without additional words, is a sufficient indorsement" (27). "An indorsement in blank specifies no indorsee, and an instrument so indorsed is payable to bearer, and may be negotiated by delivery" (28). "The holder may convert a blank indorsement into a special indorsement" (29).

§ 91. **Blank indorsement followed by special indorsement.** The holder of a bill or note, which has been indorsed in blank and delivered to him, may specially indorse it himself and transfer the instrument without completing the blank indorsement. In such a case, the last indorsement naming an indorsee, the instrument cannot be transferred without his indorsement. On the other hand, if the indorsee under a special indorsement transfers the

(27) Sec. 31.
(28) Sec. 34.
(29) Sec. 35.

instrument by a blank indorsement, the paper becomes transferable by delivery and in effect payable to bearer. For example, if H. L. Smith, the payee of a note, transfers it by the blank indorsement "H. L. Smith," so long as the indorsement remains in this form no further indorsement is necessary to a transfer of the note. But if B. Jones, to whom Smith delivered the note, transfers it by the special indorsement "Pay to H. Richards (Sgd.) B. Jones," the indorsement of Richards is necessary to a transfer. If Richards indorsed in blank "H. Richards," the instrument would again be transferable by delivery. The N. I. L. (30) states this rule in these words: "An instrument is payable to bearer . . . when the *only* or *last* indorsement is an indorsement in blank."

§ 92. **Special indorsement of instrument payable to bearer.** An instrument payable to bearer on its face may be specially indorsed by the holder. Does such a note cease to be transferable by delivery and require the indorsement of the special indorsee for its transfer? Is it like the case of an instrument payable to order, which has been indorsed in blank and then specially indorsed? No. Its character as a bearer instrument remains, and it is still transferable by delivery without indorsement. Such an indorsement has the effect, however, of making the indorser liable as such in case the maker does not pay; but his liability as indorser exists only in favor of his special indorsee. For example, A, the holder of X's note, payable to bearer, transfers it to B by the special indorsement "Pay to B (Sgd.) A." B delivers the note to C without in-

(30) Sec. 9.

dorsing it. C, by the delivery to him, becomes the owner of the note, because it was payable to bearer, but he gets no rights against A as indorser. If B had indorsed the note to C, C might have looked for payment, not only to the maker X, but also to B as indorser. The N. I. L. provides:

Sec. 40. Where an instrument, payable to bearer, is indorsed specially, it may nevertheless be further negotiated by delivery; but the person indorsing specially is liable as indorser to only such holders as make title through his indorsement.

§ 93. **Restrictive indorsement.** Under this title are grouped several kinds of indorsements of essentially different purposes and effects. The N. I. L. defines a restrictive indorsement as follows:

Sec. 36. An indorsement is restrictive which either:

1. Prohibits the further negotiation of the instrument; or

2. Constitutes the indorsee the agent of the indorser; or

3. Vests the title in the indorsee in trust for or to the use of some other person.

§ 94. **Indorsement prohibiting further negotiation.** "Pay to A only" is an example of such an indorsement (31). It shows an intent to prevent a negotiation by A. It does not disclose the purpose, whim, or fancy which induced the restriction. It seems, however, that, in the absence of evidence to the contrary, the courts assume

(31) Power v. Finnie, 4 Call, 411 (Va.).

that the indorsee is simply a trustee or agent for the indorser, and confine his rights to such as are necessary for a collection of the instrument for the benefit of the indorser (32). But if in fact the transfer was to A for his own benefit, A, although he might not transfer the instrument, could bring an action upon it against all parties to it including his transferor, and keep the proceeds when collected (33). A special indorsement which does not contain words of negotiability, e. g., "Pay to A," is not restrictive, but is of the same effect as "Pay to A, or order." If the instrument is payable to order on its face, it is negotiable by indorsement, and there is no reason why the indorsement should read also "to order" (34).

"An instrument negotiable in its origin continues to be negotiable until it has been restrictively indorsed" (35). "But the mere absence of words implying power to negotiate does not make an indorsement restrictive" (36).

§ 95. **Indorsement constituting indorsee agent or trustee of indorser.** This is the kind of restrictive indorsement which is by far the most frequently used. "Pay to Bank of X, for collection for my account. (Sgd.) A," is an every day example of such an indorsement. Other examples are: "Pay to X for account of A. (Sgd.) A"; "Pay to X for my use. (Sgd.) A." Such an indorsement vests the instrument in X as agent or trustee for A. But, more important still, it

(32) Neg. Inst. Law, sec. 37.
(33) See Hook v. Pratt, 78 N. Y. 371.
(34) Edie v. East India Co., 1 William Blackstone, 295.
(35) Neg. Inst. Law, sec. 47.
(36) Neg. Inst. Law, sec. 36.

notifies anyone dealing with the indorsee that X is not the beneficial owner, and of A's rights therein. Therefore, if X transfers the paper, A may reclaim it or its money proceeds from any transferee whatever into whose hands it may come. Thus, in the first example above, if the Bank of X, in order to facilitate the collection of the instrument, employed the Bank of Y for that purpose and indorsed the paper to it, the latter would hold the instrument for A's benefit just as the Bank of X had, and, though authorized to collect the money due, would hold it when collected for A and not for the Bank of X. In consequence, if the Bank of X was insolvent and was indebted to the Bank of Y, the latter could not apply the money collected to the payment of its claim against X, but would be compelled to pay it to A, the restrictive indorser (37). The rights which an indorser under this kind of a restrictive indorsement gets are those adapted to the purpose of the transfer, i. e., a collection of the instrument. In the words of the N. I. L. (38) they are:

"(1) To receive payment of the instrument; (2) to bring any action thereon that the indorser could bring; (3) to transfer his rights as such indorsee."

The third of these powers shows the peculiarity of this restriction, which does not restrict the further negotiation of the instrument, but expressly authorizes a transfer for the purpose of carrying out the agency. The restrictive effect of the indorsement lies simply in the fact that by

(37) Blaine v. Bourne, 11 R. I. 119.
(38) Sec. 37.

its terms it notifies all transferees of the rights of the restrictive indorser.

§ 96. **Indorsement in trust for third person.** An example of this third variety of restrictive indorsement is: "Pay to X in trust for C. (Sgd.) A;" or "Pay to the order of Mrs. Mary Hook, 35 King St., for the benefit of her son, Charlie. (Sgd.) J. P. Haskins" (39). Such an indorsement has the same effect as one in trust for the indorser himself, and is restrictive in the sense already pointed out in the last subsection, i. e., its form is notice to all purchasers of the rights of the beneficiary. But it does not prevent the further negotiation of the instrument. Taking one of the examples above, Mrs. Hook, the indorsee, has the right to transfer the instrument, but the purchaser from her is bound to ascertain at his peril whether or not she is carrying out her trust in doing so. If in fact the transfer is a breach of her trust, her son could reclaim the instrument or its proceeds from the transferee (40). There is, however, one difference between an indorsement which transfers the instrument to the indorsee for the benefit of the indorser himself, and one constituting him holder of the instrument for a third person. If the indorsement were "Pay to X for collection for my account, (Sgd.) A," or "Pay to X as trustee (or agent) for me, (Sgd.) A," it would be futile to allow the indorser X to sue A, as indorser of the instrument, for any money which X might recover, he would hold for A. So the N. I. L. provides that in such cases X can "bring any action thereon

(39) Hook v. Pratt, 78 N. Y. 371.
(40) Third Nat. Bank v. Lange, 51 Md. 138.

the indorser could bring" (41). A, the indorser, could not sue himself. But where the indorsement is in trust for a third person, as in the case of the indorsement to Mrs. Hook in trust for her son, Mrs. Hook may bring an action against the restrictive indorser Haskins, holding the proceeds when recovered, not for him, but for the son (42).

§ 97. **Qualified indorsement.** The effect of a blank or special indorsement is not only to transfer the instrument to the indorsee, but also to put him under a conditional obligation to pay the instrument, if the maker or acceptor does not. If the holder of a bill or note wishes to transfer it, without assuming this obligation, he may accomplish his object by a qualified indorsement. An example of such an indorsement by H. L. Smith is: "Without recourse to me, (Sgd.) H. L. Smith;" or simply "Without recourse, (Sgd.) H. L. Smith;" or even "Not holden (Sgd.) H. L. Smith." Any other words of the same import are sufficient to qualify the indorsement, and it makes no difference whether they precede or follow the indorser's signature. The only effect of such an indorsement is to prevent the conditional obligation of the indorser to pay if the maker does not from arising. It does not restrict the further negotiation of the instrument; nor is the indorser's unwillingness to assume that obligation such a circumstance of suspicion that the indorsee is charged with notice, if the indorser had been guilty of fraud or such other misconduct in acquiring the instrument that the courts would not allow him to enforce it (43). The N. I. L. says:

(41) Sec. 37.
(42) Hook v. Pratt, note 39, above.
(43) Epler v. Funk, 8 Barr, 468 (Pa.).

Sec. 38. A qualified indorsement constitutes the indorser a mere assignor of the title to the instrument. It may be made by adding to the indorser's signature the words "without recourse," or any words of similar import. Such an indorsement does not impair the negotiable character of the instrument.

§ 98. **Conditional indorsements.** Such indorsements are pure anomalies in the case of negotiable instruments. "Pay to X upon condition that he neither smokes nor drinks during 1910," is an example. The effect before the N. I. L. of such an indorsement is illustrated by the case of Robertson v. Kensington (44). R. Robertson was the payee of a bill accepted by Kensington & Co., bankers. He indorsed it as follows:

"Pay the within sum to Messrs. Clerk & Ross, or order, upon my name appearing in the Gazette as ensign in any regiment of the line, between the 1st and 64th, if within two months from this date. R. Robertson."

The bill was indorsed in blank by Clerk & Ross and ultimately was transferred to the Bank of England, to which it was paid by the acceptors at maturity. The condition of the indorsement, however, had not been fulfilled; Robertson's name had not appeared in the "Gazette." Robertson thereupon sued the acceptors and they were compelled to pay the bill a second time. In other words, under this decision, the maker or acceptor must determine at his peril whether or not the condition has been fulfilled. The

(44) 4 Taunton, 30.

rule of this case has been changed by the N. I. L. which provides:

"Where an indorsement is conditional, a party required to pay the instrument may disregard the condition, and make payment to the indorsee or his transferee, whether the condition has been fulfilled or not. But any person to whom an instrument so indorsed is negotiated, will hold the same, or the proceeds thereof, subject to the rights of the person indorsing conditionally" (45).

In other words, although the acceptor or maker is protected by a payment of the instrument, even if the condition has not been fulfilled, the conditional indorsee and his transferees, if the condition has not happened, hold the instrument or its proceeds, as in the case of a restrictive indorsement, for the indorser. For example, under the N. I. L., Robertson's rights would have been against the Bank of England and not Kensington & Co.

§ 99. **Delivery without indorsement.** If the payee or holder of an instrument payable to order delivers it without indorsement, title does not pass and the person taking the instrument does not become its owner. The rights which he does obtain by the transfer depend upon the nature of the transaction. If the delivery was involuntary, as in the case of theft, the mere possession of the unindorsed instrument gives the possessor no rights upon it. If the delivery was voluntary, but without intention to transfer the bill or note, as in the case of a deposit with a friend for safe keeping, the transferee obtains no

(45) Sec. 39.

rights on the bill or note. If, however, the delivery was by way of gift or sale, and the holder intended to transfer the instrument to the donee or purchaser, the transferee, while not acquiring title to the instrument and the right to sue upon it as such, obtains a right of which the holder cannot deprive him, to collect the instrument, and, if necessary, to sue upon it in the right of his transferor (46). Since he has not become the owner by the transfer, and is entitled to enforce his transferor's rights only, defences which were available against the transferor are good against him also. Thus, if A sold B worthless property, taking B's note payable to A's order for $1,000 in payment, and A sold and delivered the note to C without indorsement, B's defence would be available against C, as well as A. The fact that C innocently paid value for the note makes no difference, because C has obtained nothing more than a right to enforce A's rights. Of course, had the note been indorsed to C, he could have recovered on the note.

In addition to the right to collect the instrument, a transferee who has paid value is entitled to have the indorsement of his transferor. Such an indorsement, when made, transfers the instrument at the time it is made, and subjects the transferor to the ordinary liability of the indorser. The N. I. L. does not refer to any of the various kinds of transferees without indorsement, except the transferee who has paid value. His rights it defines as follows:

Sec. 49. Where the holder of an instrument payable to his order transfers it for value without indorsing it, the

(46) Grover v. Grover, 24 Pick. 261 (Mass.).

transfer vests in the transferee such title as the transferor had therein, and the transferee acquires, in addition, the right to have the indorsement of the transferor. But, for the purpose of determining whether the transferee is a holder in due course, the negotiation takes effect as of the time when the indorsement is actually made.

CHAPTER V.

RIGHTS OF HOLDER IN DUE COURSE.

§ 100. **In general.** We have already discussed many cases where the legal holder of a perfectly valid negotiable instrument cannot enforce the instrument. They are cases where the means by which the holder secured his legal rights were such that it would be the grossest injustice to allow him to enforce them. Such, for example, are cases where a thief steals a note payable to bearer, and by his mere acquisition of the instrument becomes the owner thereof (1); or where the payee named in a note obtains the instrument by force from the maker (2); or where the payee by means of false statements induces the maker to deliver him a note in exchange for worthless property (3); or when the payee by threats of force, or duress, secures the instrument from the maker (4); or where the maker delivers the instrument as part of a transaction declared illegal by statute, as in the case of usury.

We have also seen, that, if in any of the instances given, the fraudulent payee or holder transfers the instrument to another who purchases it in good faith and for value, there is no reason why the purchaser, who has become the owner

(1) Greeser v. Sugarman, 76 N. Y. Supp. 922.
(2) Clarke v. Johnson, 54 Ill. 296.
(3) Miller v. Finley, 26 Mich. 249.
(4) Clark v. Pease, 41 N. H. 414.

of a perfectly valid instrument for value and without notice of the wrongdoing of his transferor, should be deprived of the rights of an owner and be prevented from enforcing the instrument. The only defence which the makers had, in the various instances cited, was the injustice of allowing the wrongdoer to enforce the legal rights he had obtained by his fraud or imposition. Certainly this defence cannot be used against one who has acquired those legal rights without fraud or imposition, i. e., one who has paid value for them without notice of the wrongdoing. In consequence, the innocent purchaser from the wrongdoer is allowed to recover on the instrument. The doctrine may be stated as follows: One who has acquired the ownership of a negotiable instrument, in good faith and for value, is entitled to exercise all the rights incident to ownership, and may enforce the instrument, notwithstanding the defenses which the parties liable on the instrument may have had against the person from whom he purchased it. One entitled to the benefit of this doctrine was called, before the N. I. L., a "bona fide purchaser for value without notice." The N. I. L. terms him a "holder in due course" of business. To be a holder in due course, according to our statement of the rule, the holder must have (1) acquired an existing instrument; (2) in good faith and without notice of any defenses thereto; and (3) for value paid by him therefor.

§ 101. **Holder in due course must have acquired an existing instrument: Assent lacking.** Unless the holder can show there is a valid bill or note in existence, he has failed to show that he has acquired a negotiable instru-

ment, and the doctrine of purchase for value does not assist him. For example, we have seen (5) that a bill or note has no legal inception and does not become the obligation of the maker, drawer, acceptor or indorser, until it has been signed by him with the intention of being bound on the instrument. Applying this rule, it was held (6) that a German, who could not read English, was not bound, even to an innocent purchaser, by his signature to an instrument in the form of a promissory note, which he signed supposing it was an agency contract. The instrument, although in form a complete promissory note, was not a valid instrument. The fact that the holder of the "paper" parted with value innocently, is not of the slightest consequence, because he had *acquired* absolutely nothing but a piece of paper which was, in spite of its form, not the note of anyone. For the same reason, one who has innocently parted with value for an instrument in the form of a bill, which, although signed by the defendant, was stolen from him before it was completed, may not recover from the defendant (7). Under the law the bill had had no inception as his obligation (8). A forged instrument is another example. If A's signature as maker is forged on an instrument in the form of a note, he is liable to no one thereon, no matter how innocent the purchaser or how great the value paid.

§ 102. Same: Illegality and other defects. Again, even though the instrument is intentionally made and de-

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(5) §§ 45-47, above.

(6) Walker v. Ebert, 29 Wis. 194.

(7) Baxendale v. Bennett, L. R. 3 Q. B. D. 525.

(8) See § 53, above.

livered, it may be absolutely void by statute. In such a case the innocent purchaser acquires nothing by his purchase. Alexander v. Hazelrigg (9) is an illustration. Hazelrigg made his note payable to Lucas or order, and delivered it to Lucas for a gambling debt. The Kentucky statutes declared gambling contracts absolutely void. Alexander, knowing nothing of the origin of the note, purchased it from Lucas for a fair price. It was held that Alexander could not recover from the maker, Hazelrigg. Negotiable instruments made by infants and insane persons are further illustrations. All contracts of infants and insane persons are by law void or voidable. In consequence, one who purchases a note made by one of either of those classes of persons purchases a voidable instrument only, and neither the completeness of his innocence, nor the amount of value given, can give him any thing more than a voidable instrument, i. e., an instrument against which the maker may plead his infancy or insanity (10).

§ 103. **Same: Reasons stated.** Chief Justice Dixon of Wisconsin, in one of the cases (11) cited above, stated the true nature of the various kinds of defenses which prevail against a holder in due course as follows:

"The inquiry in such cases goes back of all questions of negotiability, or of the transfer of the supposed paper to a purchaser for value, before maturity, and without notice. It challenges the origin or existence of the paper itself; and the proposition is to show that it is not in law or in fact what it purports to be, namely, the promissory note

(9) 123 Ky. 677.
(10) Re Soltykoff [1891], 1 Q. B. 413.
(11) Walker v. Ebert, 29 Wis. 194.

of the supposed maker. For the purpose of setting on foot or pursuing this inquiry, it is immaterial that the supposed instrument is negotiable in form, or that it may have passed to the hands of a bona fide holder for value. Negotiability in such cases presupposes the existence of the instrument as having been made by the party whose name is subscribed; for, until it has been so made and has such actual legal existence, it is absurd to talk about a negotiation, or transfer, or bona fide holder of it, within the meaning of the law merchant. That which, in contemplation of law, never existed as a negotiable instrument, cannot be held to be such; and to say that it is, and has the qualities of negotiability, because it assumes the form of that kind of paper, and thus to shut out all inquiry into its existence, or whether it is really and truly what it purports to be, is petitio principii—begging the question altogether. It is, to use a homely phrase, putting the cart before the horse, and reversing the true order of reasoning, or rather preventing all correct reasoning and investigation, by assuming the truth of the conclusion, and so precluding any inquiry into the antecedent fact or premise, which is the first point to be inquired of and ascertained. For the purpose of this first inquiry, which must be always open when the objection is raised, it is immaterial what may be the nature of the supposed instrument, whether negotiable or not, or whether transferred or negotiated, or to whom or in what manner, or for what consideration or value paid by the holder. It must always be competent for the party proposed to be charged upon any written instrument to show that it is not his instrument or obligation. The

principle is the same as where instruments are made by persons having no capacity to make binding contracts; as, by infants, married women, or insane persons; or where they are void for other cause, as, for usury; or where they are executed as by an agent, but without authority to bind the supposed principal. In these and all like cases, no additional validity is given to the instruments by putting them in the form of negotiable paper."

§ 104. **Defenses not available against holder in due course.** On the other hand, any defense which does not go to the existence of the negotiable instrument as such, but merely shows that the instrument came into existence as a result of conduct on the part of the payee which makes it unjust and inequitable for him to enforce it, is not available against an innocent purchaser for value. Examples of such defenses are given in § 100, above. The N. I. L. enumerates them and states the position of a purchaser for value as follows:

Sec. 55. The title of a person who negotiates an instrument is defective within the meaning of this act when he obtained the instrument, or any signature thereto, by fraud, duress, or force and fear, or other unlawful means, or for an illegal consideration, or when he negotiates it in breach of faith, or under such circumstances as amount to fraud.

Sec. 57. A holder in due course holds the instrument free from any defect of title of prior parties and free from defenses available to prior parties among themselves, and may enforce payment of the instrument for the full amount thereof against all parties liable thereon.

§ 105. **Existing instrument must be acquired by holder in due course.** Not only must there be a valid instrument in existence, but it must have been transferred to the plaintiff, before he can claim to be an innocent purchaser. For example, Pilkington secured possession of a draft payable to Casey, or order. Pilkington forged Casey's signature as an indorsement on the instrument and delivered it to a bank, which paid value in good faith. Casey sued the bank and recovered the proceeds of the draft which had been paid to the bank. The forged indorsement did not transfer the instrument and the bank did not become the owner of it (13). For the same reason, one who purchases a note from an agent of the payee, who is not authorized to indorse and transfer it, is not protected because of his innocence. The unauthorized indorsement was not the indorsement of the payee, and ownership could not be acquired without the payee's indorsement. The doctrine of purchase for value allows one to exercise the rights which have been acquired by him, but that is all.

§ 106. **Purchase of instrument must be in good faith and without notice of defenses.** If one purchases a bill or note, knowing of the defense which the acceptor or maker has against his transferor, there is no reason in justice why the defense should not be good against him also. On the contrary, there is every reason why the defense should be available against him. It was his own folly that he paid value for the instrument. In consequence, the purchaser is not protected unless he purchased in good faith and without notice of defenses.

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(13) Casey v. Pilkington, 83 N. Y. App. Div. 91.

§ 107. **Actual notice.** The question, whether the purchase was in good faith and without notice, generally is a question of actual good faith and actual knowledge. No matter how careless or stupid the purchaser, or how suspicious the circumstances, if he can convince the court or jury that he had no knowledge of the defense, and did not wilfully shut his eyes to the means of knowledge at hand, he is entitled to the position of a holder in due course. In other words, gross negligence on the part of the purchaser, in buying under the circumstances, is not equivalent to bad faith and real knowledge. This rule was thus stated by a learned English judge in a case before the House of Lords:

"I think, however, it is now settled that, if value is given for a bill, it is not enough to show that there was carelessness, negligence, or foolishness in not suspecting that the bill was wrong, when there were circumstances which might have led to such suspicion. All these are matters which tend to show that there was dishonesty in not doing it; but they do not in themselves furnish a defense to an action on a bill of exchange. I take it that it is necessary to show, whether in the case of a party who is solvent and sui juris, or as against the estate of a bankrupt, that the person who gave value (whether great or small) for the bill was affected with notice that there was something wrong about it when he took it; but he need not have had notice of what the particular wrong was. If a man, knowing that a bill was in the hands of a person who had no right to it, should think that perhaps the holder had stolen it, when in truth the latter had obtained it by false pretences, I think he would be taking it at his

peril. But such evidence of carelessness or blindness might, with other evidence, be good evidence upon the question, which appears to be the real one, whether he knew that there was something wrong in the bill. If he was (so to speak) honestly blundering and careless, he would not be disentitled to recover; but if it appeared that he must have had a suspicion of something wrong, and that he refrained from asking questions, not because he was an honest blunderer or a stupid man, but because he thought in his secret mind: 'I suspect there is something wrong, and if I ask questions it will be no longer suspecting, but knowing, and then I shall be unable to recover,' I think that is dishonesty" (14).

The N. I. L. states the rule as follows:

Sec. 52. A holder in due course is a holder who has taken the instrument under the following conditions:

. . .

4. That at the time it was negotiated to him he had no notice of any infirmity in the instrument or defect in the title of the person negotiating it.

Sec. 56. To constitute notice of an infirmity in the instrument or defect in the title of the person negotiating the same, the person to whom it is negotiated must have had actual knowledge of the infirmity or defect, or knowledge of such facts that his action in taking the instrument amounted to bad faith.

§ 108. **Constructive notice.** The rule stated above is the general one, but it is limited by the doctrine that the

(14) Jones v. Gordon, L. R. 2 Appeal Cases, 616.

purchaser of a bill or note is charged with knowledge of everything appearing on the instrument itself. That is to say, regardless of his actual knowledge, he is treated as if he knew every fact and the legal consequences of every fact which the paper itself discloses. This is the doctrine of constructive notice.

§ 109. **Purchase after maturity.** The most important application of the doctrine of constructive notice is to instruments transferred after their maturity, i. e., after they are due. A bill or note does not lose its quality of negotiability at its maturity, but the fact that a mercantile obligation has not been paid when due is by itself enough to put all purchasers on inquiry as to its validity. Since, whether the instrument is due or not appears upon its face, a purchaser after maturity, under the rule of constructive notice, always takes the instrument subject to all defenses which the maker or acceptor had against his transferor. Brown v. Davies (15) illustrates this. Davies made a note payable to Sandal, or order, due on Nov. 13. The note was not paid at maturity, but some weeks later Davies paid the amount to Sandal, but did not receive the instrument from him. Sandal then transferred the note to the plaintiff, who paid value and had no notice of the payment. It was held that the defense was nevertheless available against the plaintiff, because he had received the instrument after its maturity. Justice Buller said:

"There is this distinction between bills endorsed before and after they become due. If a note endorsed be not due at the time, it carries no suspicion whatever on the face

(15) 3 Term Rep. 80.

of it, and the party receives it on its own intrinsic credit. But if it is overdue, though I do not say that by law it is not negotiable, yet certainly it is out of the common course of dealing, and does give rise to suspicion. Still stronger ought that suspicion to be when it appears on the face of the note to have been noted for nonpayment, which was the case here. But generally, when a note is due, the party receiving it takes it on the credit of the person who gives it to him. Upon this ground it was, that, in the case in Cornwall, I held that the defendant, who was the maker, was entitled to set up the same defense that he might have done against the original payee; and the same doctrine has been often ruled at Guildhall. A fair indorsee can never be injured by this rule; for, if the transaction be a fair one, he will still be entitled to recover. But it may be a useful rule to detect fraud whenever that has been practised."

Another of the judges said: "I think the rule laid down by my brother Buller, in the case of Cornwall, is a very safe and proper one: That where a note is overdue, that alone is such a suspicious circumstance as makes it incumbent on the party receiving it to satisfy himself that it is a good one, otherwise much mischief might arise."

§ 110. **Purchase from partner, agent, or trustee.** If one takes a negotiable instrument signed by one of the partners in the firm name, in payment of the personal debt of the partner who executed the instrument, the creditor must know from the face of the paper that it was signed by his debtor as agent for the other partners, and, in consequence, he is charged with constructive notice of the absence of authority, if such be the case, on the part of his

debtor to bind the other partners for his personal debts (16). Again, if the officer of a corporation draws a check against the corporation's bank account, in the name of the corporation, and delivers it in payment of his personal debt, the creditor who receives it cannot be a holder in due course, but is charged with constructive notice of the officer's breach of trust in using corporate funds to pay his own debts (17). But the constructive notice arises from what appears on the face of the paper. If that shows no irregularity, and the purchaser in fact acted in good faith, he is protected. Thus in Cheever v. Railroad Co. (18) it appeared that Frost, the president of the railroad, executed a promissory note in the following form:

"$5,000 Greenville, Pa., Feb'y 24, 1888.

Four months after date the Pittsburgh, Shenango and Lake Erie Railroad Company promises to pay to the order of John T. Bruen five thousand dollars at the American Exchange National Bank, New York City. Value received.

Attest: E. S. Templeton, Secretary.

The Pittsburgh, Shenango & Lake Erie Railroad Company,
By M. S. Frost, President."

Bruen, the payee named in the note, was Frost's private secretary, and immediately indorsed the instrument in blank and delivered it to Frost. Bruen acted merely as a "dummy" in the transaction. Frost transferred the note

(16) Leverson v. Lane, 13 C. B. (N. S.) 278.
(17) Rochester Road Co. v. Paviour, 164 N. Y. 281.
(18) 150 N. Y. 59.

to the plaintiff, for a loan for the personal benefit of Frost. It was held that the plaintiff could recover on the note from the railroad. In its opinion the court said: "The principle that applies in a case where an officer of a corporation makes the corporate obligation payable to himself, and then attempts to deal with it for his own benefit, does not aid in solving the question in this case. When paper of that character is presented by the officer or agent of the corporation, it bears upon its face sufficient notice of the incapacity of the officer or agent to issue it. . . . Here the officer was not dealing with corporate notes payable to himself, but with notes that had been regularly issued, so far as appeared from their face, to a stranger."

§ 111. **Transferee must part with value in exchange for the instrument.** If the transferee of a bill or note, from a payee who has secured the instrument from the maker by fraud, or force, or other means which make it unjust for him to enforce the instrument against the maker, has not parted with money or something of value for the instrument, it is just as inequitable for the transferee, as it was for the payee, to enforce the obligation of the maker. If he has paid nothing, he will be in no worse position, if the maker is not compelled to pay, than he would have been had he never received the instrument. And this is equally true, though the transferee acted in perfect good faith in accepting the transfer. Whether he was innocent or not, to allow him to recover would be to enrich him unjustly at the expense of the defrauded maker. Therefore, the N. I. L. defines a holder in due course of a bill or note as one who "took it in good faith and *for value.*"

§ 112. **What constitutes value.** "Value is any consideration sufficient to support a simple contract." " 'Value' means valuable consideration" (19). We have already defined a "sufficient" consideration as the surrender of a legal right or a promise to surrender a legal right (20). Obvious examples of consideration are the payment of money, the surrender of property, or a promise to pay money or to surrender property.

§ 113. **Pre-existing debt as value.** A creditor, who receives a bill or note in payment of his debt, surrenders value in that he has given up and absolutely extinguished his original rights against the debtor in exchange for the bill or note (21). So also one who receives a negotiable instrument on account of, but not in payment of a debt, is a holder for value, because, by receiving the instrument, he has surrendered his right to sue his debtor until the paper is dishonored by non-payment (22). Even when the instrument is taken merely as collateral security for the debt, and the creditor's rights to proceed against his debtor is neither extinguished nor suspended for an instant, it is held that the creditor is a holder for value. This was held in the case of Railroad Co. v. Bank (23). The railroad, wishing to raise money, executed a promissory note payable to its treasurer, who indorsed in blank and delivered it to Hutchinson & Ingersoll, note brokers, for the purpose of having the instrument sold by them for the benefit of the

(19) Neg. Inst. Law, secs. 25, 191.
(20) See § 57, above.
(21) Bank v. Scoville, 24 Wend. 115.
(22) Currie v. Misa, L. R. 10 Ex. Cas. 153.
(23) 102 U. S. 14.

railroad. Hutchinson & Ingersoll were indebted to the bank, and, in breach of trust, delivered the note to their creditor, which took it in good faith as security for the debt. The bank's claim against Hutchinson & Ingersoll was neither extinguished nor suspended. The bank sued the railroad, which set up as a defense the fraud of its agents in pledging the note for their personal debt, but the court held that the bank was a holder for value and could recover. Mr. Justice Harlan in his opinion said:

"Our conclusion, therefore, is that the transfer, before maturity, of negotiable paper, as security for an antecedent debt merely, without other circumstances, if the paper be so indorsed that the holder becomes a party to the instrument, although the transfer is without express agreement by the creditor for indulgence, is not an improper use of such paper, and is as much in the usual course of commercial business as its transfer in payment of such debt. In either case, the bona fide holder is unaffected by equities or defenses between prior parties, of which he had no notice. This conclusion is abundantly sustained by authority. A different determination by this court would, we apprehend, greatly surprise both the legal profession and the commercial world." The N. I. L. (24) expressly enacts that "an antecedent or pre-existing debt constitutes value."

§ 114. **Amount of value necessary.** How much money or how valuable property did the holder give for the bill or note? is generally not a material inquiry. If he gave value, whatever the amount or quantity of it, he is entitled

(24) Sec. 25.

to the position of a holder for value. Thus in Lay v. Wissman (25) it appeared that Cory and Stone had by fraud induced the defendant to make a promissory note for $150, payable to them. They indorsed "without recourse" to the plaintiff, who, in good faith and without notice of the fraud, paid $80 for the instrument. It was held that the plaintiff was a holder in due course and entitled to recover the face value of the note.

There are several apparent but not real exceptions to this rule. For example, where the purchaser paid only $5 for a $300 note of a solvent maker, it was held that the small amount was evidence of bad faith and notice, and the purchaser was not allowed to recover for that reason (26). Again, if A fraudulently induces B to make a note for $100 payable to A, and A indorses the note to C, who does not buy the paper but takes it as security for $50 advanced to A, C can only recover from B the amount actually advanced (27). The reason is that if C recovered $100 from B, C would be obliged to return $50 to A, the wrongdoer, because, as between A and C, he held the note as security only. The effect of this decision is stated in the N. I. L. in this form:

Sec. 27. Where the holder has a lien on the instrument, arising either from contract or by implication of law, he is deemed a holder for value to the extent of his lien.

§ 115. **Same: Judicial explanation.** In its opinion in Lay v. Wisman, the court stated the rule and explained

(25) 36 Iowa, 305.
(26) DeWitt v. Perkins, 22 Wis. 473.
(27) Allaire v. Hartshorne, 21 N. J. L. 665.

the apparent exceptions to it: "It is an elementary principle that the equities existing between the maker and the payee cannot be set up against the indorsee, in the ordinary course of business, for a valuable consideration, in good faith, and before maturity. There is some confusion and uncertainty in the authorities as to whether one who purchases a note for less than its face can be considered a bona fide holder. In this state, however, the rule is settled that one who purchases a note at a discount may be a bona fide holder and entitled to recover thereon. And this view has the support of both principle and authority. The amount of the consideration paid may become important in determining whether the holder is a bona fide indorsee. Where a note for $300, on a responsible person, and nearly due, was sold for $5, it was held that the indorsee was not a holder in good faith for value, and that he could not recover thereon, the note being without consideration. The amount of consideration paid becomes an important element, in connection with the responsibility of the maker, the rate of interest, the time of maturity, and the circumstance of the transfer, in determining the bona fides of the holder. And, if he is not a purchaser in good faith, he takes the note subject to the equities growing out of the note existing between the maker and the payee. When, however, the consideration paid, and the other circumstances of the purchase, show that the indorsee is a bona fide holder, in the usual course of business, there is no logical principle upon which his recovery from the maker can be reduced below the amount of the note.

"The defense that a note has been obtained fraudulently

or without consideration does not avail against a bona fide holder. If, however, the recovery of such holder may be limited to the amount paid, it is apparent that the defense does avail, for without such defense, he would recover the amount evidenced by the note. There is a class of cases in which the holder has been allowed to recover only the amount advanced upon the note. But it is believed that they will nearly, if not quite all, be found to be cases in which the holder is not a purchaser in the ordinary course of business. Thus, in Allaire v. Hartshorne (note 27, above), the note was deposited with the holder as collateral security for a pre-existing debt. The plaintiff was the owner of the note only to the extent of the debt secured. If he had recovered more, he would have held the surplus in trust for the payee. But the payee was not entitled to recover the note, as between him and the maker it being invalid. Hence, it was held, and very properly, that the holder could recover only the amount of his debt."

§ 116. **Notice to purchaser before he has parted with value.** In a case where the payee of a note, who has secured it from the maker by fraud or other unconscientious means, indorses it to X, who in good faith and without notice agrees to pay a fair price, but receives notice of the maker's defense before he has actually paid the price to the payee, it is clear that the purchaser should not be protected, if he pays after notice. To protect him under such circumstances would be just as inequitable as to protect one who has received the instrument as a gift. The law will not protect the purchaser from his own folly or assist

him in a fraud upon the maker as the case may be. The courts have applied the same reasoning to cases where the purchaser has paid part but not all of the agreed price before he receives notice, and treat such a purchaser as a holder for value only to the amount he has paid before notice. An example of this rule is the case of Dresser v. Missouri Construction Company (28). One Irwin, by means of fraud, induced the Construction Company to make and deliver to him as payee three promissory notes aggregating $10,000. Irwin sold and indorsed the instruments to the plaintiff, who paid $500 in cash and promised to pay the balance of the purchase price. Before he had done so he received notice of the maker's defense. It was conceded that the plaintiff was entitled to recover from the Construction Company the $500 paid before notice, but the plaintiff claimed the face of the notes. His claim was disallowed, the court saying:

"The argument of the plaintiff in error is that negotiable paper may be sold for such sum as the parties may agree upon, and that, whether such sum is large or small, the title to the entire paper passes to the purchaser. This is true; and if the plaintiff had bought the notes in suit for $500, before maturity and without notice of any defense, and had paid that sum, or given his negotiable note therefor, the authorities cited show that the whole interest in the notes would have passed to him, and he could have recovered the full amount due upon them."

The N. I. L. states the rule as follows:

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(28) 93 U. S. 92.

Sec. 54. Where the transferee receives notice of any infirmity in the instrument or defect in the title of the person negotiating the same, before he has paid the full amount agreed to be paid therefor, he will be deemed a holder in due course only to the extent of the amount theretofore paid by him.

§ 117. **Purchaser with notice from holder in due course.** The holder of a bill or note who has purchased it in good faith and for value ought to be permitted to exercise all of the rights incident to the ownership of the instrument. There is no reason why he should be confined to collecting the instrument from the maker. Why should he not be permitted to negotiate the instrument to whomsoever he pleases, whether by way of sale or by way of gift? That he may do so is well settled. In consequence, a defrauded maker cannot object to the plaintiff's recovery on the ground that he paid nothing for the note, but received it as a gift from an innocent purchaser. Nor can the maker object that the transferee of the innocent holder for value knew of the fraud when he received the instrument, or that he received the paper after maturity. To allow the maker such a defense would be in effect to deprive the innocent purchaser of one of his rights on the instrument, i. e., to transfer it as he pleases and to whom he will.

§ 118. **Same: Participant in prior wrongdoing.** This doctrine, which allows the transferee of a holder in due course to recover from the maker, though he received the instrument after maturity, paid no value, and had notice of the maker's defense, obviously ought not to be applied

in a case where the instrument gets back into the hands of the party who was guilty of the fraud. The reasons for this limitation of the rule are well stated by Judge Cooley in a case (29) where the payee, who had secured a note from the maker by fraud, sold it to an innocent purchaser and then bought it back again. That learned judge said:

"It is perfectly true, as a general rule, that the bona fide holder of negotiable paper has a right to sell the same, with all the rights and equities attaching to it in his own hands, to whomever may see fit to buy of him, whether such purchaser was aware of the original infirmity or not. Without this right he would not have the full protection which the law merchant designs to afford him, and negotiable paper would cease to be a safe and reliable medium for the exchange of commerce. For, if one can stop the negotiability of paper against which there is no defense, by giving notice that a defense once existed while it was held by another, it is obvious that an important element in its value is at once taken away. But I am not aware that this rule has ever been applied to a purchase by the original payee, nor can I perceive that it is essential to the protection of the innocent indorsee, that it should be. It cannot be very important to him, that there is one person incapable of succeeding to his equities, and who consequently would not be likely to become a purchaser. If he may sell to all the rest of the community, the market value of his security is not likely to be affected by the circumstance that a single individual cannot compete for its pur-

(29) Kost v. Bender, 25 Mich. 515.

chase, especially when we consider that the nature of negotiable securities is such that their market value is very little influenced by competition. Nor do I perceive that any rule or principle of law would be violated by permitting the maker to set up this defense against the payee, when he becomes indorsee, with the same effect as he might have done before it had been sold at all, or that there is any valid reason against it."

The doctrine and its limitations are stated in the N. I. L. as follows:

Sec. 58. . . . But a holder who derives his title through a holder in due course, and who is not himself a party to any fraud or illegality affecting the instrument, has all the rights of such former holder in respect to all parties prior to the latter.

CHAPTER VI.

OBLIGATIONS OF PARTIES AND TRANSFERORS.

SECTION 1. CONTRACTS OF PARTIES TO INSTRUMENT.

§ 119. **Contract of maker and acceptor.** A promissory note must contain an "unconditional promise" to pay at a designated time. "The maker of a negotiable instrument by making it engages that he will pay it according to its tenor" (1). The maker, then, is absolutely and unconditionally bound to pay his note at its maturity. A bill of exchange is an "unconditional order" to the drawee to pay at the designated time, and his acceptance is an assent to the order. The acceptor, therefore, is absolutely and unconditionally bound to pay the bill at its maturity, and stands under an obligation with respect to a bill similar to that of the maker of a note.

§ 120. **Presentment for payment.** Since the maker or acceptor is unconditionally bound to pay the holder at maturity, it is his duty to seek him out and discharge his obligation by payment. It is not the duty of the holder to disclose his whereabouts or to present the instrument for payment, but he may if he chooses, the instant the instrument is overdue, institute an action against the acceptor or maker and compel him to pay not only the sum

(1) Neg. Inst. Law, sec. 60.

due upon it, but also the costs of the action. Notwithstanding the very terms of a bill or note payable on demand, this rule is applied to them, and it is the duty of the maker or acceptor to pay without demand (2). Even where the instrument is expressly payable at a special place, e. g., at a particular bank, the holder is not bound to present it at the bank for payment; nor is the maker or acceptor discharged by having money deposited in that bank set apart for the payment of the instrument. The N. I. L. (3) does provide that "if the instrument is, by its terms, payable at a special place, and he is able and willing to pay it there at maturity, such ability and willingness are equivalent to a tender of payment upon his part." But even a tender of payment does not discharge the acceptor or maker: its utmost effect is to stop the running of interest, and to prevent the holder from recovering the costs in an action brought after the tender (3a).

§ 120a. **Contract of drawer and indorser.** The N. I. L. describes the contracts of the drawer of a bill and indorser of either a bill or note as follows:

Sec. 61. The drawer by drawing the instrument . . . engages that on due presentment the instrument will be accepted or paid or both, according to its tenor, and that if it be dishonored, and the necessary proceedings on dishonor be duly taken, he will pay the amount

(2) Sec. 70.

(3) Sec. 70.

(3a) Hills v. Place, 48 N. Y. 520.

thereof to the holder, or to any subsequent indorser who may be compelled to pay it.

Sec. 66. Every indorser who indorses without qualification . . . engages that on due presentment, it shall be accepted or paid or both, as the case may be, according to its tenor, and that if it be dishonored, and the necessary proceedings on dishonor be duly taken, he will pay the amount thereof to the holder, or to any subsequent indorser who may be compelled to pay it.

Obviously the contracts of the drawer and indorser are alike in that they are conditional, and in that both are conditional upon the happening of the same events, i. e., non-payment by the maker or acceptor, due "presentment," and "necessary proceedings on dishonor." What presentment and proceedings on dishonor are, we shall consider later (Chapter VII, below). Here it is sufficient to note that the drawer and the indorser do not become liable unless the acceptor or maker fails to pay. It is for this reason the N. I. L. describes the liability of the drawer and indorser as "secondary"; that of the maker or acceptor as "primary." It provides:

Sec. 192. The person primarily liable on an instrument is the person who by the terms of the instrument is absolutely required to pay the same. All other parties are "secondarily" liable.

§ 121. **Order of liability of parties.** The normal liability of the various parties to a negotiable instrument may be made plainer by an illustration. A draws a bill of

exchange on X payable to B, and delivers it to B. By drawing the instrument A assumes an obligation to B, or, if B transfers the bill, to whomever happens to be the holder, to pay the bill, if X, the drawee, refuses to accept and pay. So far, A is the only party bound on the bill. B secures X's acceptance. Thereupon X becomes primarily and unconditionally bound to pay B, or, if B transfers the bill, to pay whomever happens to be the holder. Now there are two obligations on the instrument running to B. B indorses to C. C, by the transfer, gets B's rights against both the acceptor, X, and the drawer, A; but he also obtains a third obligation, i. e., that of B, as indorser, who by his indorsement promises to pay if the acceptor does not. C indorses to D, and D thereupon succeeds to the rights of C against X, A, and B, and also obtains the conditional liability of C as indorser. At maturity it is the duty of the acceptor, the person primarily liable, to pay D forthwith. If he does pay, not only his own but every other obligation on the instrument is discharged. A's, B's and C's liability was only a conditional one, to pay if X did not. If X does not fulfil his obligation, then, upon presentment and after the necessary proceeding upon dishonor, the liability of each of the other parties becomes absolute, and each is bound to pay D the amount of the bill forthwith.

§ 122. **Same (continued).** D may collect from any one of the three he chooses, but, of course, he is not entitled to receive the amount of the bill from more than one of the parties. If he collects from C, the latter, receiving the instrument from D, becomes the holder and comes within

the promise of the acceptor. He also falls precisely within the contract of both A and B for the same reason, i. e., that he has become the holder. C, then, at his option, may look either to X, or to A, or to B for payment. If he secures payment from X, the instrument is discharged just as it would have been had the acceptor paid the holder, D, in the first instance. If he looks to B and recovers, B may in turn recover from either X or A. If the acceptor pays B, the instrument is discharged and with it the liability of A. But if B compels A, the drawer, to pay, he has no one from whom to seek reimbursement except X, the acceptor. If D had in the first place collected from A, the drawer, the result would have been the same: A's payment would have discharged the indorsers, B and C. Had D looked to B, the first indorser, B's payment would have discharged C, the second indorser. As between themselves, the drawer and indorsers are liable in the order in which they became parties to the instrument. That is to say, an indorser, who has been compelled to pay, may seek reimbursement from the drawer and the prior indorsers, but not from subsequent indorsers. But, as between the drawer and indorsers, on the one hand, and the holder on the other, the drawer and each of the indorsers is liable, without regard to the order of time in which they respectively became parties to the instrument.

§ 123. Same: Among indorsers. In determining the order of liability of the indorsers among themselves, it is the order *in time* in which they become parties to the instrument which controls, and not the order in which their signatures appear on the back of the paper. H. L. Smith,

the payee of an instrument, may have placed his blank indorsement, "H. L. Smith," across the back near the middle, and his transferee, H. Richards, may have indorsed in blank placing his signature above that of Smith. Nevertheless, Smith, the payee, is the first indorser and liable as such, and Richards is the second indorser. When it is remembered that the indorsements do not even have to be on the back of the instrument, but may be scattered over its face, it is obvious that the order of the names on the paper is not a reliable guide to the order of the indorsers' liability.

§ 124. **Contract of aval or anomalous indorser.** No one but the payee or subsequent holder of a negotiable instrument can properly be an indorser. But mercantile usage permits a person, who is neither payee nor holder, to assume a liability thereon by indorsing his name upon the instrument. Such a person is called an *aval.* Since he is neither acceptor, maker, drawer, nor in the proper sense an indorser, the courts have found the greatest difficulty in defining his liability. The N. I. L. has solved the problem by providing that he shall be liable as indorser:

Sec. 63. A person placing his signature upon an instrument, otherwise than as maker, drawer, or acceptor, is deemed to be an indorser, unless he clearly indicates by appropriate words his intention to be bound in some other capacity.

Thus, if the payee of a note offers it for sale to a bank but the bank refuses to buy, doubting the ability of the maker and indorser to pay, the payee may induce X, a

third person, to indorse his name on the paper for the purpose of giving it credit with the bank. X is an aval or anomalous indorser, and, under the N. I. L. assumes the same obligation to the bank and subsequent holders, as a regular indorser. The N. I. L. (4) expressly provides: "If he signs for the accomodation of the payee he is liable to all parties subsequent to the payee." His rights, also, upon being compelled to pay, are the same as those of an ordinary indorser, i. e., he may obtain reimbursement by an action on the note against the maker or the prior indorsers, including the payee for whose accommodation he signed. It makes no difference whether X or the payee signed first, or in what order their names appear on the back of the paper. The payee is always, as we have seen, the first indorser and liable as such.

§ 125. **Same: Indorsement before inception.** In the case just discussed the irregular indorsement was placed on the note, after it had been delivered to the payee and had had its inception as a negotiable instrument. Suppose, however, the indorsement had been made before the maker had delivered the note. The N. I. L. defines the liability of such an anomalous indorser as follows:

Sec. 64. Where a person, not otherwise a party to an instrument, places thereon his signature in blank before delivery, he is liable as indorser, in accordance with the following rules:

1. If the instrument is payable to the order of a third

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(4) Sec. 64 (3).

person, he is liable to the payee and to all subsequent parties.

2. If the instrument is payable to the order of the maker or drawer, or is payable to bearer, he is liable to all parties subsequent to the maker or drawer.

These rules are made clearer by examples. An illustration of the operation of Rule 1 is a case where A makes a note payable to the order of B, his creditor, and offers the note in payment of the debt. B refusing to receive the note, A induces X to indorse his name upon the note in order to give it credit with B, who, relying on the indorsement of X, takes the note in payment of A's debt. The manifest intention of the parties is that X shall be liable to B and holders subsequent to B. This intention is effectuated by Rule 1. An example of Rule 2 is a case where A, the drawer of a bill drawn payable to his own order, secures X's indorsement, before he delivers it to B. Here again X's intention appears to be to bind himself to B and subsequent holders. Rule 2 fixes X's liability in accordance with this intention. The peculiarity in both of these cases is, that, as a formal matter, B is the payee and therefore the first indorser, and, were it not for the anomalous character of X's indorsement, would be liable to X who is subsequent to him.

§ 126. **Qualified indorsement.** An indorser "without recourse" refuses to assume the contract obligation of an indorser, and consequently is not bound as such. His responsibility to his transferee is described in § § 135-40, below.

§ 127. **Indorser of bearer instrument.** The holder of a bearer instrument need not, and usually does not, indorse it, but "where a person places his indorsement on an instrument negotiable by delivery he incurs all the liabilities of an indorser" (5). If he transfers without indorsement he assumes none of the contract liabilities of an indorser, but stands under a responsibility to his transferee similar to that of an indorser without recourse. See § § 135-40, below.

§ 128. **Indorsement by infant.** The indorsement of an infant, whatever its effect, does not subject the infant to any contract liability as indorser. The contracts of an infant are either void or voidable. The same is true in the case of indorsement by any person who has not capacity to contract, as for example a corporation whose powers do not include that of being a party to negotiable paper (6).

SECTION 2. ADMISSIONS OF MAKER, DRAWER AND ACCEPTOR.

§ 129. **Admissions of maker, drawer, and acceptor as to payee.** The maker of a note, or the drawer of a bill, designates the payee. If the instrument is negotiable in form, the maker expressly authorizes and apparently contemplates its transfer by the payee. Therefore, if an insane person, a "fictitious person," an infant, or any person not having full legal capacity to deal with his property, is designated by the maker or drawer as payee, the maker or

(5) Neg. Inst. Law, sec. 67.
(6) Neg. Inst. Law, sec. 22.

drawer is not permitted to set up as a defense against a purchaser of the instrument from the payee, his non-existence or want of capacity and the consequent want of title in his transferee, the purchaser. The drawee, also, after promising to pay a bill, for the same reason is not permitted to question the existence or capacity of the payee named in it. The N. I. L. states this rule as follows:

Sec. 60. The maker of a negotiable instrument by making it . . . admits the existence of the payee and his then capacity to indorse.

Sec. 61. The drawer by drawing the instrument admits the existence of the payee and his then capacity to indorse.

Sec. 62. The acceptor by accepting the instrument . . . admits . . . the existence of the payee and his then capacity to indorse.

§ 130. **Same: Illustrations.** An example of the operation of this rule is a case where Massey made a note payable to Hess, or order. Hess was an infant. Hess indorsed to the plaintiff, who brought an action against the maker, Massey. The maker's defense that the infant's indorsement did not transfer the note to the plaintiff was disallowed (7). The court said: "The disability of an infant to make a valid, binding contract, is a personal privilege intended for the benefit of the infant himself, and none but he, or his representatives, can take advantage of such disability. Besides this, the defendant, by making the note to Hess, asserted to the world his competency to negotiate and assign the paper, and he cannot

(7) Frazier v. Massey, 14 Ind. 382.

be permitted to gainsay the assertion so made." Another illustration is a note made payable to "X, attorney general, or order." X's indorsee, even though the indorsement was beyond X's official authority, would be entitled to recover from the maker (8).

§ 131. **Admissions of acceptor.** An acceptance operates not only as a promise to pay the bill, and as an admission of the existence and capacity of the payee, but also as an admission of "(1) the existence of the drawer, (2) the genuineness of his signature, and (3) his capacity and authority to draw the instrument" (9).

§ 132. **Acceptor's admission of drawer's existence, capacity and authority.** For the same reason that the maker, drawer, and acceptor are precluded from denying the existence and capacity of the payee, the acceptor by accepting a bill, i. e., by assenting to the order of a drawer, admits the drawer's existence, his legal capacity, and authority to draw the bill, and to that extent the validity of the bill to which he has given currency by his acceptance. In an action against him upon his acceptance, it is no defense that in fact there was no drawer, the name signed to the bill not designating any person; or that the drawer was an infant, or a lunatic, with no capacity to draw a bill; or that he was not indebted to the drawer, who drew upon him without right or authority. Thus, if A, upon presentment to him, accepts a bill purporting to be drawn by a person of whom he has never heard, and to whom he owes nothing, he is bound by his acceptance to a holder for

(8) Wolke v. Kuhne, 109 Ind. 313.
(9) Neg. Inst. Law, sec. 62.

value. "The delivery of a bill or check by one person to another for value implies a representation on the part of the drawer that the drawee is in funds for its payment, and the subsequent acceptance of such check or bill constitues an admission of the truth of the representation, which the drawee is not allowed to retract. By such acceptance the drawee admits the truth of the representation, and, having obtained a suspension of the holder's remedies against the drawer, and an extension of credit by his admission, is not afterwards at liberty to controvert the fact as against a bona fide holder for value of the bill" (10).

§ 133. **Acceptor's admission of drawer's signature.** A drawee, by accepting, admits the signature to the bill to be the genuine signature of the drawer and not a forgery. But, as the result of an arbitrary distinction, he does not admit that the body of the bill has not been altered between the time of drawing and accepting. Thus, if A forges B's signature as drawer to a bill drawn on C, inserting his own as payee, and negotiates the instrument to D, who pays value in good faith, and C accepts the bill in ignorance of the forgery, D may recover from C on his acceptance. But had B drawn a genuine bill on C payable to A, and had A altered it by raising the amount, for example; in such a case C's subsequent acceptance would not bind him, and D, the innocent purchaser, could not recover against him on his acceptance. In other words, the acceptor admits the genuineness of the signature but not the genuineness of the body of the bill. A striking illustration of this rule is the case of the National Park

(10) Heuertematte v. Morris, 101 N. Y. 63.

Bank v. Ninth National Bank (11). A bill was drawn by the Ridgely Bank of Illinois on the National Park Bank, payable to one Shirly. The draft was stolen, the name of the payee changed, the amount raised from $14.20 to $6,300, and the signature of the drawer erased and then re-written as before. The instrument was then negotiated to the Ninth National Bank, which paid value for it in good faith. Thereafter it was accepted by the Park Bank. It was conceded that the Park Bank would not have been bound by its acceptance if the only alteration had been as to the payee and amount, for its acceptance admitted the genuineness of the drawer's signature only. But the drawer's signature was not genuine. It had been erased and re-written. In consequence, the court held the Park Bank bound to pay; for the bill had not been altered since the signature, which its acceptance admitted to be genuine, had been attached to the instrument. The court said: "For more than a century it has been held and decided, without question, that it is incumbent upon the drawee of a bill to be satisfied that the signature of the drawer is genuine, that he is presumed to know the handwriting of his correspondent, and, if he accepts or pays a bill to which the drawer's name has been forged, he is bound by the act, and can neither repudiate the acceptance nor recover the money paid."

§ 134. **Forged indorsements.** The drawee of a bill payable to order is bound by his acceptance to pay the payee or his order, but no one else. If the payee's indorsement is forged, the instrument is not transferred and

(11) 46 N. Y. 77.

the payee is not deprived thereby of his right to receive payment. It makes no difference in the application of this rule that the drawee accepted the instrument after the forgery of the payee's indorsement, and that the holder purchased innocently after the drawee had placed his acceptance on the bill. The acceptor does not admit the genuineness of the indorsements. He promises to pay the legal holder of the bill at maturity (12).

Section 3. Vendor's Warranties of Transferor.

§ 135. **Liability of transferor as seller.** The transfer of a negotiable instrument for a consideration is a sale, and the transferor is therefore subjected as seller to certain liabilities to his transferee, similar to those of the seller of any property. These liabilities are not the result of indorsement, but arise quite independently because the transfer is a sale. In consequence, they are the same in a case of a transfer of a bearer instrument by delivery, and in the case of a transfer by a qualified indorsement, by which the holder of an instrument payable to order indorses it without assuming the contract obligation of an indorser to pay if the maker or acceptor does not. That the liability of a transferor as indorser and his responsibility as seller are distinct is made clear by two examples. A, the holder of a note payable Jan. 1, 1911, sells and indorses it to B on Jan. 1, 1910. Immediately after the transfer, the maker absconds, a bankrupt without assets. B has no action against A on his indorsement, until the maturity of the note on Jan. 1, 1911. But, if the note had been a

(12) First Bank v. Bank, 152 Ill. 296.

forgery, B, upon discovering the invalidity of the instrument, might have sued A at once upon his implied warranty as seller that the note was genuine.

§ 136. **Warranties of transferor.** The N. I. L. states the warranties of the seller of a bill or note as follows:

Sec. 65. Every person negotiating an instrument by delivery or by a qualified indorsement, warrants:

1. That the instrument is genuine and in all respects what it purports to be;
2. That he has a good title to it;
3. That all prior parties had capacity to contract;
4. That he has no knowledge of any fact which would impair the validity of the instrument or render it valueless.

But when the negotiation is by delivery only, the warranty extends in favor of no holder other than the immediate transferee. The provisions of subdivision three of this section do not apply to persons negotiating public or corporate securities, other than bills and notes.

Sec. 66. Every indorser, who indorses without qualification, warrants to all subseqent holders in due course:

1. The matters and things mentioned in subdivisions one, two and three of the next preceding section.

§ 137. **Warranty of genuineness.** The warranty of the transferor that "the instrument is genuine and in all respects what it purports to be" makes him responsible to his transferee, if the instrument is forged, or void by statute, or for any reason never had an inception as the obligation of the maker, acceptor, or drawer, whose name

appears thereon; and his ignorance of the invalidity of the paper does not affect his liability. For example in Hannum v. Richardson (13) the defendant sold and indorsed "without recourse" to the plaintiff a piece of paper which purported to contain a promissory note. In fact the obligation was absolutely void by a statute of the state. It did not appear that the defendant acted in bad faith or knew of he illegality. It was held that the defendant was nevertheless liable on his warranty. The court said:

"By indorsing the note 'without recourse' the defendant refused to assume the responsibility and liability which the law attaches to an unqualified indorsement, so that, in respect to such liability, it may perhaps be regarded as standing without an indorsement. If it be so regarded, then in what position do these parties stand in respect to the transaction? The principle is well settled that where personal property of any kind is sold, there is on the part of the seller an implied warranty that he has title to the property, and that it is what it purports to be, and is that for which it was sold, as understood by the parties at the time; and, in such case, knowledge on the part of the seller is not necessary to his liability. The implied warranty is, in this respect like an express warranty, the scienter need not be alleged or proved. . . . In this case the note in question was given for intoxicating liquor sold in this state in violation of law, and therefore was void at its inception; in short, it was not a note, it was not what it purported to be, or what it was sold and purchased for; it is of no more effect than if it had ben a blank piece of

(13) 48 Vermont, 508.

paper for which the plaintiff had paid his fifty dollars. In this view of the case, we think the defendant is liable upon a warranty that the thing sold was a valid note of hand."

§ 138. **Warranty of title.** If a note is stolen from the payee, his indorsement forged, and the paper sold by the thief to an innocent holder, the holder does not obtain title. Nor can he transfer what he does not own. If he attempts to sell the instrument, his sale passes nothing to the transferee. The transferee, therefore, may recover under such circumstances from the transferor for breach of the warranty that "he had good title" to the instrument (14).

§ 139. **Warranty of capacity of prior parties.** Not only is the transferee entitled to get from his transferor title to a valid instrument, but he has a right to the contract obligations of the parties as the paper discloses them. For example, an infant holder of a bill or note may transfer the instrument by his indorsement, although his indorsement places him under no liability as indorser (15). One, therefore, who buys a note bearing a prior indorsement by an infant, may recover from his transferor. One at least of the prior parties did not have capacity to contract, and the transferee did not obtain the obligations of all the parties he naturally expected were bound on the instrument.

§ 140. **Warranty of no knowledge of facts rendering instrument valueless.** The insolvency of the acceptor or maker at the time of the transfer, or at any other time,

(14) Williams v. Savings Institution, 57 Miss. 633.
(15) Neg. Inst. Law, sec. 22.

does not charge the transferor on any of his warranties. To be sure, if it results in the inability of the maker or acceptor to pay at maturity, the transferor, if he has indorsed, may be held as indorser. But the transferor, when he sells an instrument which although legally valid is of no practical value, because of the insolvency of the parties to it or other reason, warrants that he has no *knowledge* of any fact which renders it valueless. For example, the plaintiff sold the defendant a check drawn and indorsed, to plaintiff's knowledge, by an insolvent person. The defendant gave plaintiff a note for the purchase price. In an action on the note, the defendant relied for a defense on plaintiff's breach of warranty. It was held the defense was good. "Where a party negotiates commercial paper," said the court, "payable to bearer, or under the blank indorsement of another person, he cannot be sued on the paper, because he is not a party to it; but he nevertheless warrants that he has no knowledge of any facts which prove the paper to be worthless, on account of the failure of the makers, or by its being already paid, or otherwise to have become void or defunct; for, says Judge Story, 'any concealment of this nature would be a manifest fraud' " (16).

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(16) Brown v. Montgomery, 20 N. Y. 287.

CHAPTER VII.

PRESENTMENT AND PROCEEDINGS ON DISHONOR.

SECTION 1. PRESENTMENT FOR PAYMENT.

§ **141. Necessity of presentment.** The maker or acceptor of a negotiable instrument is bound to pay at maturity, without a presentment or any demand of payment whatever, even in the case of a note payable "on demand" (1), but the first step in making absolute the conditional liability of the drawer and indorsers is presentment for payment to the maker or acceptor.

"Presentment for payment is not necessary in order to charge the person primarily liable on the instrument. . . . But, except as herein otherwise provided, presentment for payment is necessary in order to charge the drawer and indorser" (2).

§ **142. Day for presentment.**

"Where the instrument is not payable on demand, presentment must be made on the day it falls due" (3). "Every negotiable instrument is payable at the time fixed therein without grace" (4).

(1) See § 120, above.
(2) Neg. Inst. Law, sec. 70.
(3) Neg. Inst. Law, sec. 71.
(4) Neg. Inst. Law, sec. 85.

If the instrument is payable Jan. 1st, presentment must be made on that day. An instrument dated Jan. 31st, and payable one month after date, must be presented on Feb. 28th or 29th, as the case may be. A bill or note dated Jan. 1st, payable "ten days after date," must be presented on Jan. 11, and a note payable "ten days after my death," the maker of which dies on Jan. 1st, matures and must be presented on Jan. 11th. As the N. I. L. says:

Sec. 86. Where the instrument is payable at a fixed period after date, after sight, or after the happening of a specified event, the time of payment is determined by excluding the day from which the time is to begin to run, and by including the date of payment.

Instruments falling due on Saturday are to be presented for payment on the next succeeding business day, except that instruments payable on demand may, at the option of the holder, be presented for payment before twelve o'clock noon on Saturday when that entire day is not a holiday (5).

§ 143. **When demand instruments must be presented.** The payee of a bill or note payable on demand is entitled to its payment immediately upon its delivery, and, if he chose, he might forthwith maintain an action upon it against the maker or acceptor. In this sense a demand instrument is due on the day of its issue, and, if the ordinary rule were applied—that presentment must be made at maturity—a presentment good against parties who indorsed after that day would be impossible. But the rule

(5) Neg. Inst. Law, sec. 85.

is that an instrument indorsed after maturity is, as regards the person so indorsing, payable on demand (6). Thus the ordinary rule cannot apply to demand instruments. The N. I. L. says that where the instrument "is payable on demand, presentment must be made within a reasonable time after its issue" (7). For example, X, the holder of a demand note made by A and indorsed successively by B, C, and D, by presenting it to A, within a reasonable time after its issue by A, could hold the indorsers. Suppose, however, X held the note until after a reasonable time had elapsed, and then indorsed to Y. As regards X, the instrument would have the effect of a note payable on demand issued on the day of his indorsement. Consequently, if Y made a presentment for payment to the maker, A, within a reasonable time after X's indorsement, the presentment would be good as against X, although of course it would not revive the liability of the prior indorsers, B, C, and D (8).

§ 144. **What is a reasonable time for presentment?** What is a reasonable time is a question of fact for the solution of which the law offers no rule. A reasonable time within which to make presentment may be a day or two in the case of a check, or a month or two in the case of a bill or note. The N. I. L. provides:

Sec. 193. In determining what is a "reasonable time" or an "unreasonable time," regard is to be had to the nature of the instrument, the usage of trade or business (if

(6) N. I. L., sec. 7.
(7) N. I. L., sec. 71.
(8) Turner v. Mining Co., 74 Wis. 355.

any) with respect to such instruments, and the facts of the particular case.

§ 145. When delay in making presentment is excused. In Patience v. Townley (9), an action against an indorser on a bill due in Leghorn on Sept. 10, 1800, the plaintiff proved a presentment on October 31, 1800. He also proved that, though he sent out the bill in time for presentment on Sept. 10th, the occupation of Leghorn by the enemy made presentment on that day impossible. The court held that the presentment on October 31st was sufficient, saying: "Duly presented is presented according to the custom of merchants, which necessarily implies an exception in favor of those unavoidable accidents which must prevent the party from doing it within the regular time." In another case the illness of the holder, serious enough to prevent him from presenting the bill in person or from employing an agent to act for him, was held to excuse a delay in making presentment (10). These cases serve to illustrate the general rule laid down in the N. I. L.:

Sec. 81. Delay in making presentment for payment is excused when the delay is caused by circumstances beyond the control of the holder, and not imputable to his default, misconduct, or negligence. When the cause of delay ceases to operate, presentment must be made with reasonable diligence.

§ 146. Place of presentment: When place specified.

(9) 2 Smith (Eng.) 223.
(10) Wilson v. Senier, 14 Wis. 380.

The place of payment of a negotiable instrument may be designated either by expressly making it "payable at" a specified place, or by the maker or acceptor adding an address to his signature. An instrument in which the place of payment is specified must be there presented (11). Thus, an instrument payable "at the First National Bank," or "at 114 South Main St., St. Louis," or "at New York city," must be presented at the place named. Where the place named is a town, e. g., New York city, the presentment must be at the residence or place of business of the acceptor or maker in New York city; but, if he has neither, the presence of the instrument in the city in the possession of the holder or his agent authorized to collect, is the proper mode of presentment. The most convenient mode of effecting the presentment of a bill or note, payable generally in a city or town, is to send it for collection to a bank doing business there. The bank then would present it at the maker's or acceptor's office or residence, or, if he had neither, the presence of the bill in the bank would be sufficient. A presentment not made at the place specified for payment is of no effect. For example, a personal presentment to the maker or acceptor at another place, or a presentment at his actual place of business or residence, if that is not the place specified, is insufficient (12).

§ 147. **Same: When no place specified.** If no place of payment is specified in the instrument, presentment must be made at the place of business or the residence

(11) Neg. Inst. Law, sec. 73 (1) (2).
(12) First Bank v. Bank, 152 Ill. 296.

of the maker or acceptor (13). The holder may choose either and is not bound to present at both, even if no one is found at the place chosen. If the maker or acceptor has either an office or a home, a personal presentment to him elsewhere, for example, on the street, or in another's office, is insufficient (14).

If no place of payment is specified in the instrument, and the maker or acceptor has no place of business or residence, the presentment is good if made to the maker or acceptor personally wherever he can be found, or if made at his last known place of business or residence. In such a case, if the maker or acceptor's whereabouts or his last place of business or residence cannot be ascertained by the holder after a reasonable effort, the drawer and indorsers of the bill or note are bound without presentment. The N. I. L. provides for such a case as follows:

Sec. 82. Presentment for payment is dispensed with: (1) Where after the exercise of reasonable diligence presentment as required by this act cannot be made. . . .

§ 148. **Hour of presentment.** Not only must the presentment be made on the proper day and at the proper place, but it must be at a reasonable hour. If the place of payment is a business office, the customary hours of business would fix the exterior limits of the time for presentment. These naturally vary in different towns. If a presentment is properly made at a residence, it should be made

(13) Neg. Inst. Law, sec. 73 (3).
(14) See Parker v. Kellogg, 158 Mass. 90; King v. Crowell, 61 Me. 244.

between the usual hours of rising and retiring in that community. For instance, the presentment of a note at the maker's residence in a suburb of Boston, at 9 o'clock in the evening, was held sufficient although the maker and his family were in bed (15). In discussing the reasonableness of the hour the court said:

"The note declared on, not being payable at a bank, or at any place where business was transacted during certain stated hours in each day, was properly presented to the maker at his place of residence. It was also the duty of the holder to present it within reasonable hours on the day of its maturity. No fixed rule can be established by which to determine the hour beyond which a presentment, in such case, will be unreasonable and insufficient to charge an indorser. Generally, however, it should be made at such hour that, having regard to the habits and usages of the community where the maker resides, he may be reasonably expected to be in a condition to attend to ordinary business. In the present case, taking into consideration the distance of the place of residence of the maker from Boston, where the note was dated, and where it was held when it became due; the means that were taken to ascertain the residence of the maker, and the season of the year at which the note fell due, we are of opinion that a presentment at nine o'clock in the evening was seasonable and sufficient. It is quite immaterial that the maker and his family had retired for the night. The question whether a presentment is within reasonable time cannot be made to depend on the private and peculiar habits of

(15) Farnsworth v. Allen, 4 Gray, 453 (Mass.).

the maker of a note, not known to the holder; but it must be determined by a consideration of the circumstances, which, in ordinary cases, would render it seasonable or otherwise."

§ 149. **Hours for presentment at bank.** When the place of presentment is a bank, presentment must be made during banking hours, i. e., the hours during which the bank is open for the transaction of business over its counters. Presentment after banking hours, though the bank's doors may still be open and its officers present is too late. There is, however, an exception to this rule which has been sanctioned by the N. I. L.:

Sec. 75. Where the instrument is payable at a bank, presentment for payment must be made during banking hours, unless the person to make payment has no funds there to met it at any time during the day, in which case presentment at any hour before the bank is closed on that day is sufficient.

§ 150. **Presentment must be by holder or his agent.** Any person in possession of a bill or note payable to bearer or indorsed in blank is the holder of the instrument, and a proper person to make presentment, whether or not he is in fact acting for himself, or for the benefit of a third person who is entitled to the proceeds when collected. But the holder of a note specially indorsed to him, who does not wish to present it in person, may employ an agent for the purpose. There is no necessity of indorsing the instrument to the agent, even by a restrictive indorsement; nor is any written authorization necessary. A simple de-

livery of the instrument unindorsed, with authority to collect it, constitutes the agent a proper person to make a presentment (16).

§ 151. **To whom presentment must be made.** The N. I. L. says:

Sec. 78. Where there are several persons, not partners, primarily liable on the instrument, and no place of payment is specified, presentment must be made to them all.

Sec. 77. Where the persons primarily liable on the instrument are liable as partners, and no place of payment is specified, presentment for payment may be made to any one of them, even though there has been a dissolution of the firm.

This rule—that where there are several makers or acceptors who are not partners, presentment must be made to each—does not mean that personal presentment to each is necessary, but that such a presentment to each must be made as would be sufficient were he the only maker or acceptor. So far as personal presentment is concerned, the rule is the same with respect to instruments with several makers or acceptors, as in the case of instruments with one maker or acceptor. No personal presentment of an instrument payable at a particular place is necessary. If the holder or his agent, with the bill or note in his possession, applies for payment at the place specified, at a reasonable hour, the presentment is good, whether the acceptor or maker or any one representing him is present

(16) Neg. Inst. Law, sec. 72 (1).

or not. Where the proper place of presentment is the office or the residence of the acceptor or maker, the presentment is good, even if the doors of the office or house be closed and no answer can be obtained. In this case it is the *place* and not the *person to whom*, which determines the effect of the presentment.

§ 152. **Presentment is demand of payment accompanied by exhibition of instrument.** Since the instrument must be surrendered upon its payment, a presentment for payment should be accompanied by a production of the instrument, or, at least, an ability forthwith to produce it. If the maker or acceptor unqualifiedly refuses to pay before the instrument is produced, there seems to be no occasion for the formal act of exhibiting it. The N. I. L. provides generally:

Sec. 74. The instrument must be exhibited to the person from whom payment is demanded, and when it is paid must be delivered up to the party paying it.

Section 2. Presentment for Acceptance.

§ 153. **When presentment for acceptance necessary.** Until a bill of exchange has been accepted, the drawee is under no obligation to the payee or holder to pay it. The rights of the holder are against the drawer and indorsers, who have promised conditionally to pay if the drawee does not. If the holder wishes the promise of the drawee, he may present the bill to the drawee requesting his acceptance. But, in general, the holder has the option, either of presenting the bill before maturity for acceptance, or of

waiting until maturity and presenting it for payment. There are, however, certain cases where the failure of the holder to make a presentment for acceptance will discharge the drawer and indorsers (17). The N. I. L. enumerates them as follows:

Sec. 143. Presentment for acceptance must be made:

1. Where the bill is payable after sight, or in any other case where presentment for acceptance is necessary in order to fix the maturity of the instrument;

2. Where the bill expressly stipulates that it shall be presented for acceptance; or

3. Where the bill is drawn payable elsewhere than at the residence or place of business of the drawee.

In no other case is presentment for acceptance necessary in order to render any party to the bill liable.

§ 154. **Dishonor by non-acceptance.** Whether a presentment for acceptance is necessary or not, if it is actually made and the drawee refuses to accept, the bill is dishonored and the holder is entitled to immediate payment from the drawer or indorsers, although the bill may not be due for months or years (18). But the obligations of the drawer and indorsers are conditional upon due notice of dishonor, which must be given in accordance with the rules governing a notice of dishonor by non-payment (19).

Section 3. Notice of Dishonor.

§ 155. **In general.** After presentment for payment to

(17) Neg. Inst. Law, sec. 144.
(18) N. I. L., sec. 150.
(19) See §§ 155-70, below.

the acceptor or maker, the next step in fixing the liability of the drawer and indorsers is notice to them that the instrument has been dishonored. Such a notice is called a *notice of dishonor.*

§ 156. **Form of notice.**

"The notice may be in writing or merely oral and may be given in any terms which sufficiently identify the instrument and indicate that it has been dishonored by . . . non-payment" (20). "A written notice need not be signed, and an insufficient written notice may be supplemented and validated by verbal communication. A misdescription of the instrument does not vitiate the notice, unless the party to whom the notice is given is in fact misled thereby" (21).

A notice of dishonor, then, may be an unsigned communication in writing, or an oral communication, or a communication partly written and partly oral. The notice (1) ought to identify the dishonored instrument, and (2) must indicate that it has been dishonored by non-payment.

§ 157. **Identification of dishonored instrument.** The usual and proper mode of describing the dishonored instrument in a notice of dishonor is by giving its amount, its date, its date of maturity, and the names of all the parties to it. But, as the N. I. L. says, a misdescription, and by implication an incomplete description, does not vitiate the notice, if the person receiving it knows that it relates to a bill or note upon which he is drawer or indorser. For

(20) Neg. Inst. Law, sec. 96.
(21) N. I. L., sec. 95.

this reason, a notice which misstated the amount and did not state the names of the indorsers, has been held sufficient (22), the court saying: "The defendant, however, does not show that he was in the least misled or confused by the omission, or by the mistake. On the contrary, it clearly appears that he understood the notice to refer to the note in suit. He was, therefore, fully informed of the dishonor of this note and that the holder looked to him for payment. This was sufficient to fix his liability."

§ 158. **Indication of dishonor.** An instrument is "dishonored by non-payment when it is duly presented for payment and payment is refused or cannot be obtained" (23). An indication of dishonor is therefore an indication (1) that a technical presentment for payment has been made, and (2) that the instrument is unpaid. Both of these elements of a "dishonor by non-payment" must appear from the notice by "reasonable intendment," although they need not be expressly stated in it. Under this rule, a mere statement that the instrument is due and unpaid is insufficient. There may have been no presentment (24). Again, a statement that payment has been demanded is not enough. Due presentment is a presentation of the instrument to the maker or acceptor, as well as a demand. A notice stating directly that the instrument has been "dishonored" or "protested" is valid, because the reasonable intendment is that the proper steps to dishonor the paper have been taken.

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(22) King v. Hurley, 85 Me. 525.
(23) Neg. Inst. Law, sec. 83.
(24) Daniel on Neg. Inst., sec. 983.

§ 159. **By whom notice may be given.** The proper person to give notice of dishonor in the first instance is the holder. But any indorser to whom the holder has given notice may also serve notice on indorsers prior to him. If he were not permitted to do this, the liability of the prior indorsers to him might not be fixed; for the holder is not obliged to give notice to all indorsers, but only to such as he wishes to hold, and only indorsers to whom notice is sent are bound. However, before an indorser can give notice, his liability as such must have been fixed. A notice of dishonor can be given only by the holder, or by an indorser whose liability to pay the holder has become absolute. For example, a notice by an indorser who has been discharged, because no notice has been served upon him, is ineffectual. So also is a notice sent by a stranger. The N. I. L. says:

Sec. 90. The notice may be given by or on behalf of the holder, or by or on behalf of any party to the instrument who might be compelled to pay it to the holder, and who, upon taking it up, would have a right to reimbursement from the party to whom the notice is given.

An illustration may make this clearer. X is the holder of a note, indorsed successively by A, B, C, and D. Upon dishonor, X may give notice to all the indorsers, in which event each becomes responsible to X for the amount of the note; or he may give notice to D only. If he pursues the latter course, D's responsibility to X being fixed, D may, in order to protect himself, give notice to any or all of the three prior indorsers. Neither B nor C, however, is en-

titled to give notice to A, until notice has been received from D.

§ 160. **Effect of notice.** Suppose D does send notice to C, and C in turn to B, what effect has the serving of these notices on the rights of the holder? They have the same effect in fixing the liability of B and C as notices sent by him personally. In like manner, C's notice to B enures to the benefit of D. The result is that each of these indorsers, B, C, and D, is responsible for the amount of the note to X; if D pays it, he may look for reimbursement to either B or C; but if B pays it, he is without recourse on A who has received notice from no one. The N. I. L. states the rule as follows:

Sec. 93. Where notice is given by or on behalf of a party entitled to give notice, it enures to the benefit of the holder and all parties subsequent to the party to whom notice is given.

If we suppose that the holder, X, instead of notifying D only, had also notified A, the notice would fix the liability of A not only to X but also to D. And, to carry the case a step further, had D notified B and C, the intermediate indorsers between him and A, the notice to A would operate for their benefit as well as for that of D. In other words, due notice from the holder to the first indorser fixed his liability to all subsequent indorsers who were themselves bound to the holder. The N. I. L. says:

Sec. 92. Where notice is given by or on behalf of the holder, it enures to the benefit of . . . all prior par-

ties who have a right of recourse against the party to whom it is given.

§ 161. **Notice by agent.** It is not necessary for the holder, or for a party entitled to give notice, to attend personally to the matter. He may, and usually does, act by an agent. A notice of dishonor sent by an agent is peculiar in that it need not be given in the name of his principal, but may be given in the agent's own name, or in the name of any other party who is entitled to give notice. For example, X is the holder of a note indorsed successively by A, B, and C. X gives notice to the last indorser, C, who employs Y to notify A and B. A notice by Y in his own name, as holder, is sufficient, although he is not the holder. And a notice by Y, in the name of the holder X, who has not authorized him to act, is good. This is provided in the N. I. L.:

Sec. 91. Notice of dishonor may be given by an agent, either in his own name or in the name of any party entitled to give notice, whether that party be his principal or not.

§ 162. **Time within which notice must be given.** Notice of dishonor may be given as soon as the instrument is dishonored (25). If a bill or note is presented at ten o'clock in the morning of the day of maturity and payment is not obtained, the dishonor is complete and notice may at once be given. Or, if an indorser receive notice from the holder, he may at once notify the prior indorsers. But such ex-

(25) Neg. Inst. Law, sec. 102.

pedition is not necessary. The time within which notice must be given is determined by certain definite rules which have been incorporated in the N. I. L.:

Sec. 103. Where the person giving and the person to receive notice reside in the same place, notice must be given within the following times:

1. If given at the place of business of the person to receive notice, it must be given before the close of business hours on the day following.

2. If given at his residence, it must be given before the usual hours of rest on the day following.

3. If sent by mail, it must be deposited in the postoffice in time to reach him in usual course on the day following.

Sec. 104. Where the person giving and the person to receive notice reside in different places, the notice must be given within the following times:

1. If sent by mail, it must be deposited in the postoffice in time to go by mail the day following the day of dishonor, or, if there be no mail at a convenient hour on that day, by the next mail thereafter.

2. If given otherwise than through the postoffice, then within the time that notice would have been received in due course of mail, if it had been deposited in the post-office within the time specified in the last subdivison.

Sec. 94. Where the instrument has been dishonored in the hands of an agent, he may either himself give notice to the parties liable thereon, or he may give notice to his principal. If he give notice to his principal, he must do so within the same time as if he were the holder, and the

principal, upon the receipt of such notice, has himself the same time for giving notice as if the agent had been an independent holder.

§ 163. **Successive notices.** An illustration of the operation of these rules will show that, although the time within which a notice of dishonor must be given or despatched by mail is fixed, the time within which an indorser will receive notice may vary greatly with the circumstances. Y is the agent for collection of a bill for the holder X. The bill is indorsed by A, B, C, D, and E, who indorsed successively in the order named. Upon dishonor, Y the agent, may notify each of the five indorsers on behalf of the holder X. If he pursues this course the notices if sent by mail, must be deposited in the post-office not later than the day following the dishonor. A delay by him until the second day after dishonor (unless the circumstances bring the case within Sec. 104-1) would discharge A, B, C, D, and E. Y, however, instead of notifying the indorsers, may despatch a notice by mail to his principal, X. Upon its receipt, X may wait until the day following before mailing a notice to E, the fifth and last indorser. E, taking the full time allowed for giving notice, may notify the fourth indorser, D, who in turn notifies C, and so on. It is perfectly possible that several weeks or even longer may elapse before A, the first indorser receives notice. Yet when he is notified, he is just as effectually bound as if a notice had been sent him directly by the holder or his agent.

§ 164. **To whom notice must be given.** The N. I. L. provides:

Sec. 100. Notice to joint parties who are not partners must be given to each of them, unless one of them has authority to receive such notice for the others.

Sec. 99. Where the parties to be notified are partners, notice to any one partner is notice to the firm, even though there has been a dissolution.

Sec. 98. When any party is dead, and his death is known to the party giving notice, the notice must be given to a personal representative, if there be one, and if with reasonable diligence he can be found. If there be no personal representative, notice may be sent to the last residence or last place of business of the deceased.

§ 165. **Where notice must be sent.** If the message constituting the notice, whether oral or in writing, whether delivered in person, by messenger, or sent through the mail, is actually received by the indorser, within the time that would have been required for delivery had the notice been sent to the place designated by the law as the proper address to which the notice must be sent, the notice is sufficient (26). But, if the holder does not wish to assume the risk of the message being actually received within the proper time, the simple course, whatever the means of transmission may be, is to address it in accordance with the following rules laid down in the N. I. L.:

Sec. 108. Where a party has added an address to his signature, notice of dishonor must be sent to that address; but if he has not given such address, then the notice must be sent as follows:

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(26) Neg. Inst. Law, sec. 108.

1. Either to the post-office nearest to his place of residence, or to the post-office where he is accustomed to receive his letters; or

2. If he live in one place, and have his place of business in another, notice may be sent to either place; or

3. If he is sojourning in another place, notice may be sent to the place where is so sojourning. . . .

§ 166. **Same: Illustrations.** If the indorser were a farmer, who, to suit his convenience, received his mail at the one of two neighboring post-offices more distant from his home, notice might properly be sent to either under Rule 1. Rule 2 would apply to the case of an indorser residing in a suburban town whose place of business is in a large city. An example of Rule 3 is the case (27) of a notice sent to Daniel Webster at Washington, while he was there attending to his duties as a United States senator, although his legal residence and office were in Boston. It was held that the notice addressed to Washington, the place of his temporary residence or sojourning, was sufficient, the court saying:

"The ground relied upon to show that such notice was not sufficient is that the defendant's general domicile and place of business were in the city of Boston, where he had at all times an agent, who had the charge and management of his affairs. The defendant, though his domicile was at Boston, was actually resident at Washington, in discharge of his public duties as a senator, at a session of Congress called by public proclamation, and continued until after

(27) Chouteau v. Daniel Webster, 6 Metcalf, 1 (Mass.).

the time at which this notice was sent; so that the place where he might be presumed to be actually residing was fixed and well known by the nature of these duties. Under these circumstances, the court are of the opinion that notice to the defendant by mail, addressed to him at Washington, was good and sufficient notice of the dishonor of these notes. This decision is founded on the circumstances of the particular case, and may be varied by other facts. It is not like a case of a merchant stopping for a day or two at a hotel or watering-place, or on a journey of business or pleasure."

§ 167. **When notice dispensed with or delay excused.** If, within the regular period for sending notice, the necessary data to enable the holder to give proper notice cannot, after the exercise of reasonable diligence, be ascertained, a delay is excused. But, "when the cause of delay ceases to operate, notice must be given with reasonable diligence" (28). In Gladwell v. Turner (28a) it appeared that the bill was drawn by the defendant on one Welsh, at three months after date, duly accepted, and afterwards indorsed to one Smith, who indorsed it to the plaintiff. It became due on Friday the 17th of September, 1869, and was presented on that day to Welsh by the plaintiff, but was dishonored. All the parties to the bill lived in London. On the day following its dishonor, the plaintiff, with a view of giving notice to the defendant, and being ignorant of his address, applied to Smith for information. Smith was from home; but later on the same day, at about

(28) Neg. Inst. Law, sec. 113.
(28a) L. R. 5 Ex. 59.

half-past five in the afternoon, the plaintiff went to him again, and obtained the defendant's address. He posted his notice of dishonor the same evening, but not until after six o'clock. The consequence was that it was not received by the defendant until Monday, the 20th of September. If it had been posted before six, the defendant would, in the ordinary course of the London postal delivery, have received it on Saturday evening. The court held the delay in giving notice excused, saying:

"The holder of a bill is not bound, omissis omnibus aliis negotiis, to devote himself to giving notice of its dishonor. He must, however, use due and reasonable diligence, or the notice will be too late. Now here, unless we are prepared to say as a matter of law that the plaintiff was under an absolute necessity of writing and posting his notice in the half hour which elapsed from his discovery of the defendant's address and six o'clock, I am of opinion that there was evidence of sufficiently reasonable diligence, both in discovering the address and in posting the notice. The notice was therefore in time."

If the address which the holder ascertains after diligent inquiry is incorrect, notice sent there is sufficient, though it is never received. And if the holder's diligence does not result in information as to the indorser's whereabouts, or a proper place of address, notice is unnecessary. The N. I. L. says:

Sec. 112. Notice of dishonor is dispensed with, when, after the exercise of reasonable diligence, it cannot be given to or does not reach the parties sought to be charged.

Section 4. Protest.

§ 168. **Necessity for protest.** The conditional liability of the drawer and indorsers of promissory notes and of *inland* bills of exchange is fixed by a due presentment and due notice of dishonor. But in the case of *foreign* bills of exchange, an additional act must be performed by the holder in order to charge the drawer and indorsers. He must protest the bill.

§ 169. **Inland and foreign bills.** An inland bill is one drawn and payable in the same state. A foreign bill is one drawn in one state and payable in another. Thus, a draft drawn in Wisconsin, directing payment to be made in Chicago, is a foreign bill. In case neither the place of drawing nor the place of payment appears from the face of the bill, the holder may treat the instrument as an inland bill (29). This option is given the holder in order to relieve him from the necessity of determining at his peril whether or not a protest is necessary.

§ 170. **Requisites of protest.** The *first* step in protesting a bill of exchange is its formal presentment for acceptance or payment, as the case may be; the *second*, is "noting" the dishonor; and the *third*, the preparation and execution of the certificate of protest. Each of the steps must be taken by a notary public (30). The presentment by the notary must be in accordance with the ordinary rules governing presentment (31). The "noting" is the making by the notary of a memorandum on the bill of

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(29) Neg. Inst. Law, sec. 129.

(30) N. I. L., sec. 154; Ocean Bank v. Williams, 102 Mass. 141.

(31) See §§ 141-52, above.

the facts later to be incorporated in the certificate of protest. The "noting" must be made on the same day as the presentment and dishonor. If the certificate is executed by the notary upon the day of presentment, there is no occasion for a "noting." But either the "noting" or the certificate itself must be made on that day (32). If the certificate is not then executed, "the protest may be subsequently extended as of the date of the noting" (33). The requisites of the certificate of protest, called the "protest," which is a document signed and sealed by the notary who presented the bill, are stated in the N. I. L.:

Sec. 153. The protest must be annexed to the bill, or must contain a copy thereof, and must be under the hand and seal of the notary making it, and must specify;

1. The time and place of presentment;

2. The fact that presentment was made and the mauner thereof;

3. The cause or reason for protesting the bill;

4. The demand made and the answer given, if any, or the fact that the drawee or acceptor could not be found.

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(32) Neg. Inst. Law, sec. 155.
(33) N. I. L., sec. 155.

CHAPTER VIII.

CHECKS.

§ 171. Peculiarities of checks. A bill of exchange drawn on a bank and payable on demand is called a check. There would be no occasion for mentioning this particular kind of bill, were it not for two peculiar rules applicable to them. Apart from these peculiarities a check stands on the same footing as any other bill (1).

§ 172. Certification. Instead of demanding payment, the holder may present a check to the bank on which it is drawn requesting that the bank certify upon its face that the drawer's account is "good" for the amount of the check. If the bank assents to the request by writing "Certified" or "Good" upon the check, the bank makes the instrument its own absolute obligation—in effect, its promissory note or certificate of deposit, and the drawer and indorsers are discharged (2). Thereafter, the holder must look to the bank alone for payment. The instrument, however, continues negotiable, and, if it is transferred by indorsement, the indorsers subsequent to the certification are of course liable as such. For the same reason, if the drawer of a check secures its certification before he delivers it to the payee, he remains liable. The practical consequence

(1) Neg. Inst. Law, sec. 185.
(2) N. I. L., sec. 188.

is, that, if the holder obtains the certification, he is the loser in the event of the bank's failure; but, if the check was certified for the drawer, he is responsible in case of the bank's insolvency (3).

§ 173. Time within which checks must be presented: To hold drawer. The general rule is that bills of exchange payable on demand must, in order to charge the drawer and indorsers, be presented within a reasonable time after their issue. But the drawer of a check remains liable thereon indefinitely, unless he is actually injured by the delay in making presentment. "A check must be presented for payment within a reasonable time after its issue, or the drawer will be discharged from liability thereon to the extent of the loss caused by the delay" (4). Furthermore, what is a reasonable time within which to present a check within this rule is a question to which usage has given a more definite answer than in the case of other kinds of bills. In Grange v. Reigh (5), for example, it appeared that the defendants, after banking hours on July 20, drew and delivered to plaintiff in Milwaukee, where plaintiff resided, a check for $1,211 upon the South Side Savings Bank, located in Milwaukee. The check was not presented on July 21st, during all of which day the bank was open and would have paid the check had it been presented. The bank did not open after July 21, by reason of which the check was not paid. In holding that the loss by reason of the bank's failure must fall upon the plaintiff, the court said: "The settled law applicable to the facts

(3) Head v. Hornblower, 156 Mass. 458.
(4) Neg. Inst. Law, sec. 186.
(5) 93 Wis. 552.

of this case, is, that, if a person receives a check on a bank, he must present it for payment within a reasonable time, in order to preserve the right of recourse on the drawer in case of non-payment by the drawee; and that, when such person resides and receives the check at the same place where such bank is located, a reasonable time for such presentation reaches, at the latest, only to the close of banking hours on the succeeding day, excluding Sundays and holidays. Plaintiff failed to comply with the law in this respect; hence defendants were discharged from all liability to answer for the default of the bank."

§ 174. **Same: To hold indorsers.** With respect to indorsers also a check must be presented more promptly than other bills. When the parties all reside in the same place, the holder should present the check on the day it is received or on the following day; and, when payable at a different place from that in which it is negotiated, the check should be forwarded by mail on the same or the next succeeding day for presentment.

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(6) Smith v. Janes, 20 Wend. 192 (N. Y.).

CHAPTER IX.

DISCHARGE OF INSTRUMENT.

§ 175. **Payment.** Payment by the acceptor or maker to the holder, at or after maturity, discharges the contract of the acceptor or maker and the contract of every other party to the instrument. The life of the paper as an obligation has ended, and in no way and in favor of no one can the obligation of the parties to it be revived. If the bill or note is not surrendered to the maker or acceptor at the time of payment; or if, in the case of surrender, it is put in circulation again, without his consent, no purchaser of the paper can acquire any rights against the parties who had been the acceptor, maker, drawer, or indorsers before its discharge (1).

§ 176. **Payment must be to the holder.** Payment to effect a discharge must be to the holder, i. e., the legal owner of the instrument (2). In consequence, payment to the person in possession of a bill or note payable to order, upon which the payee's indorsement is forged, is not a discharge of the instrument (3). That, in such a case, the maker or acceptor paid in good faith and the person receiving payment was innocent, makes no difference.

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(1) Neg. Inst. Law, sec. 119 (1).
(2) N. I. L., secs. 119 (1), 88.
(3) Smith v. Sheppard, Chitty on Bills (10th Ed.) 180, note.

However, if the bill or note is payable to bearer, payment in good faith to any one in possession of it will discharge the instrument. The instrument being transferable by delivery, the person in possession is the legal owner thereof (4).

§ 177. **Payment must be at or after maturity.** Payment before maturity does not discharge a negotiable instrument (5). Its utmost effect is to make it unconscientious for the holder who has received payment to enforce the instrument. "Payment," said a learned judge, in holding that an innocent purchaser before maturity could recover on a note, which had been paid before its maturity but had subsequently passed into the plaintiff's hands, "means payment in due course, and not by anticipation. Had the bill been due before it came into the plaintiff's hands, he must have taken it with all its infirmities. In that case, it would have been his business to inquire minutely into its origin and history. But, receiving it before it was due, there was nothing to awaken his suspicion. I agree that a bill paid at maturity cannot be reissued, and that no action can afterwards be maintained upon it by a subsequent indorsee. A payment before it becomes due, however, I think does not extinguish it any more than if it were merely discounted" (5a).

§ 178. **Payment by drawer or indorser.** Payment by the drawer of a bill, or the indorser of a bill or note, satisfies his liability to the holder, but does not discharge the instrument, or the obligations of the maker or acceptor

(4) Anonymous, Style, 366.
(5) Neg. Inst. Law, secs. 119 (1), 88.
(5a) Burbridge v. Manners, 3 Campbell 193.

and the prior indorsers. Upon his payment he is entitled to receive the instrument from the holder, and to enforce it against the prior parties, or, if he wishes, to transfer it by way of sale or gift. The N. I. L. provides:

Sec. 121. Where the instrument is paid by a party secordinarily liable thereon, it is not discharged; but the party so paying it is remitted to his former rights as regards all prior parties, and he may strike out his own and all subsequent indorsements, and again negotiate the instrument.

§ 179. **Same: Illustrations.** For example, C sells property worth $100 to B, taking in payment a note of $100 made by A payable to B, indorsed by B to C. C indorses the note to D. A does not pay at maturity, and C is compelled to pay D. D can enforce the instrument against A or B. The instrument is not discharged, because the absolute and unconditional promise of the acceptor or maker to pay has not been fulfilled by the indorser's payment in satisfaction of his own obligation to pay if the maker or acceptor does not. The prior indorsers are not discharged, because they have assumed an obligation to every subsequent holder to pay if the maker did not, and he has not paid. The indorser who has paid and received the instrument is entitled to enforce it against the prior parties, or to transfer it because he has become the holder (6). The indorser who has taken up the instrument can not enforce it against indorsers subsequent to himself. In the example above, had the holder D secured payment from the

(6) Serra v. Berkley, 1 Wilson, 46; Callow v. Lawrence, 3 Maule & S. 95.

first indorser B, instead of from the second C, B would have no rights against C. To allow B to pursue C on the instrument would be futile; for, were C compelled to pay, he could turn about, and, under the general rule that prior indorsers are not discharged, compel B to repay him (7).

§ **180. Cancelation and alteration.** In addition to payment by the acceptor or maker, there are two other principal ways in which a negotiable instrument may be discharged, cancelation and alteration. A cancelation includes, as well as canceling, a destruction or mutilation of the paper on which the bill or note is written, or an erasure of the writing. But, "a cancelation made unintentionally, or under a mistake, or without the authority of the holder, is inoperative" (8).

An alteration is any change made in the material terms of the instrument. No matter by whom, or under what circumstances, the alteration is made, it effects a discharge of the instrument unless all of the parties consent (9). But the N. I. L. makes an exception to this strict rule in favor of purchasers, who, ignorant of the alteration, have innocently parted with value for the paper:

Sec. 124. . . But when an instrument has been materially altered and is in the hands of a holder in due course, not a party to the alteration, he may enforce payment thereof according to its original tenor.

The N. I. L. enumerates what alterations are material as follows:

(7) Neg. Inst. Law, sec. 120 (4).
(8) N. I. L., sec. 123.
(9) N. I. L., sec. 124.

Sec. 125. Any alteration which changes:

1. The date;
2. The sum payable, either for principal or interest;
3. The time or place of payment;
4. The number or the relations of the parties;
5. The medium or currency in which payment is to be made; Or which adds a place of payment where no place of payment is specified, or any other change or addition which alters the effect of the instrument in any respect, is a material alteration.

§ 181. **Discharge of indorsers.** The discharge of the instrument by payment, cancelation, or alteration extinguishes the obligation of every party liable on it. But an indorser may be discharged without a discharge of the instrument. For example, he is discharged by an intentional cancelation of his signature (10). An indorser is also discharged by any dealings of the holder with prior parties, which affect the indorser's right to proceed against them in case he is compelled to pay the holder (11). For example, if the holder of a note indorsed by A, B, and C, intentionally cancels A's signature, B and C are discharged. By the cancelation of A's indorsement his liability on the instrument is discharged, and the right of B and C to look to him for reimbursement is gone. In consequence it would be unjust to allow the holder to collect from Band C (12).

(10) Neg. Inst. Law, sec. 120 (2).
(11) N. I. L., sec. 120.
(12) See Newcomb v. Raynor, 21 Wend. 108.

GUARANTY AND SURETYSHIP

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CHAPTER I.

CONTRACT OF GUARANTY OR SURETYSHIP.

§ 1. Parties to suretyship agreements. A person who engages to be answerable for the debt, default, or miscarriage of another is called a surety or guarantor. He undertakes to pay either jointly or severally with the principal, the debtor who is primarily liable; or he may undertake to pay only if the latter does not. He is an insurer of the debt, and is usually bound with the principal by the same instrument, executed at the same time, and for the same consideration, and is often an original promisor and debtor from the beginning. When there are two or more sureties bound with the principal for the performance of the same obligation, or parts of the same

obligation, they are *co-sureties* even though bound for different sums and though they become bound at different times. Thus if A is the principal on a bond for $2,000, and B becomes surety for the entire sum and C surety for $1,500 of it, B and C are co-sureties and may have a right of contribution as to each other, i. e., if one has to pay the debt, he can force the other to contribute or share the burden with him. This right of contribution will be discussed later (§§ 89-99). B and C in the above example are co-sureties, that is, they are bound for the performance, by the same principal, of the same obligation. Co-sureties may become bound at different times, for different amounts, and may be ignorant of the fact that there are other co-sureties. So long as it is for the performance of the same obligation they are co-sureties.

§ 2. **Capacity of parties.** As to the capacity of parties to become sureties, the law is the same in respect to infants and insane persons as in case of any other sort of contract. See Contracts, §§ 67-72, in Volume II of this work. A corporation as a rule has no power to become a surety, unless such power can be implied from the nature of its business. Such power may be implied whenever reasonably necessary or usual in the conduct of its business. Surety and guaranty companies, which are now very common, are organized under express statutes for the purpose of becoming sureties.

§ 3. **Distinction between suretyship and guaranty.** A strict surety is directly liable to the creditor for the act to be performed. He is bound with and for another, who is primarily liable, and who is called the principal.

When we say the principal is primarily liable this only means he is primarily liable as between the principal and surety. Both principal and surety are directly liable to the creditor. The strict surety undertakes to pay the debt in the first instance, just as the principal does. On the other hand, a guarantor undertakes to pay only if the principal fails to do so; or, in case of a guaranty of collectability, if he is insolvent and unable to pay. This failure or inability of the debtor to pay the debt must first be shown, before the guarantor becomes liable. In a strict guaranty the guarantor does not undertake to do what the debtor is bound to do, but his obligation is that the debtor will perform the obligation, or, if he fails to perform, the guarantor will pay such damages as result from the failure. The contract of a guarantor is thus collateral and secondary, instead of direct like that of a strict surety. The term surety is commonly loosely used to cover both strict sureties and guarantors. The law as to the two discussed in this article does not differ greatly, except in cases involving the statute of frauds, so usually no attempt will be made to make any distinction.

§ 4. **Guaranty a collateral undertaking.** As was stated in the proceeding subsection, a guarantor promises to pay the debt if the principal does not do so. His undertaking is secondary—it is his own separate, independent contract distinct from that of the principal debtor. When one who owns a promissory note endorses it and transfers it to another, such endorser is a species of guarantor of the note, under special conditions imposed by the law of negotiable paper. See Negotiable Instruments, Chap-

ters VI and VII, in Volume VIII. He is liable to the owner of the note, if the maker does not pay. In other words, he promises the one to whom he transfers the note, that, if the maker does not pay it, he, upon the performance of certain conditions, will do so; and the transferee takes the note relying on this promise. It is clear here that the endorser made a contract separate and distinct from that of the maker of the note and founded on a distinct consideration, namely the taking of the note by the transferee. It is a collateral undertaking. Since a contract of guaranty is a contract independent of that out of which the debt of the principal arose, it always requires a consideration, but the same act or promise may be a consideration for the principal's contract and a guaranty made at the same time. For instance, when the guaranty is given in consideration of the creditor's advancing money or goods to the principal, such advances furnish good consideration for the guaranty. Where there is a guaranty of a pre-existing obligation, however, there must always be some new consideration in order to make a valid guaranty.

§ 5. **Statute of frauds.** The fourth section of the old English statute of frauds provided that no action should be brought whereby to charge the defendant upon any special promise to answer for the debt, default, or miscarriage of another person, unless the agreement upon which such action shall be brought, or some memorandum or note thereof, should be in writing and signed by the party charged therewith or by some other person thereunto, by him lawfully authorized. This section of the

statute of frauds has been re-enacted throughout the United States with but few modifications.

§ 6. **Contract of guaranty must be in writing.** When the contract is merely one of guaranty, it is clearly a special promise to answer for the debt, default, or miscarriage of another person, and consequently is within the statute of frauds and must be in writing. If the special promise creates a liability to pay for another, that is, if the promisor agrees to pay if the debtor does not, the promise must be in writing. There must be a principal debtor, and the special promise must be made to the creditor to whom the principal debtor has already become liable, or is thereafter to become liable. It is evident that a contract of strict suretyship is not within the statute of frauds, because the surety promises the creditor, with out condition, that he will pay him and is directly and jointly (or jointly and severally, or severally) liable with the principal debtor. His is a direct unconditional promise to pay the debt, and not a promise to answer for the debt, default, or miscarriage of the princapal. This is illustrated by the old English case of Watkins v. Perkins (1) where the court said that if A promise B, a surgeon, that if B cure D of a wound, he will see him paid; that is only a promise to pay if D does not and therefore ought to be in writing, but if A promise, in such case, that he will be B's paymaster whatever he shall deserve, it is immediately the debt of A, and he is liable without writing. The question as to whether a promise is within the statute of frauds is important and arises frequently, because

(1) 1 Lord Raymond, 224.

contracts of guaranty are apt to be informally made. A person, in order to enable a friend or relative to get credit, will often use an expression like, "I will see that you are paid," or, "If he don't pay you I will." If the party to whom such a promise is made gives the desired credit and later sues on such promise, the question arises as to whether it was a promise within the statute of frauds and therefore must be in writing, or whether it is not within the statute and is therefore enforcable though orally made.

§ 7. **When is a debt within the statute of frauds?** Any sum of money due on express contract is, of course, a debt the payment of which may be guaranteed, but the question has arisen in respect to quasi-contractual and tort obligations, and it has been contended that a guaranty of such obligation is not within the statute of frauds especially when there is only a contingent liability. The leading case on this point is Buckney v. Darnall (2). In this case the defendant promised orally to answer for any injury to a horse, which might be caused by a third person to whom the plaintiff loaned the horse for a certain purpose. The horse was injured while in the hands of the person who borrowed him, and the defendant was sued on his promise to pay the damages. The court held the plaintiff could not recover because the contract was within the statute of frauds and must be in writing. This shows a pure tort obligation may be guaranteed. The language of the statute is broad enough to include all

(2) 2 Lord Raymond, 1085.

sorts of obligations and, beginning with the above case, the courts have so held.

§ 8. **Necessity of principal debtor and promise to creditor.** In order to bring a guaranty within the statute of frauds so that it is required to be in writing, it is necessary that there be a principal debtor who is liable to the creditor; for, if there is no such debtor, the promise to pay cannot be a guaranty. It is also necessary that the principal debtor be at some time contemporaneously liable with the guarantor. Thus, when the defendant in an action brought against him had promised orally to pay a certain person's funeral expenses, if the deceased's nephew did not, the court held that, since the nephew was not liable for any such expenses, there was no principal obligation and the defendant's promise was not within the statute; hence, though orally made, the defendant was liable on it (3). Furthermore, the special promise must be made by the guarantor to the creditor. For instance, when A was liable to B on a promissory note and D promised A orally that he would pay B, the court held the case could not be within the statute of frauds because the promise was not made to the creditor B (4).

§ 9. **When promisor receives the benefit.** The statute of frauds applies only to contracts which the promisor makes for the benefit of the principal debtor. It is often said that if the guarantor makes a promise which is chiefly for his own benefit, instead of for the debtor's benefit, his promise is not within the statute of

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(3) Mease v. Wagner, 1 McCord (S. Car.) 395.
(4) Eastwood v. Kenyon, 11 Adolphus & Ellis, 438.

frauds and is enforcable though not in writing; or, if the promise is in effect to pay the promisor's own debt, though the debt of another is incidentally guaranteed, the contract need not be in writing. In the case of Davis v. Patrick (5) we find these principles illustrated. The defendant had promised to advance certain sums of money to a mining company, and the latter in return was to furnish him a large quantity of ore free of cost and to allow the plaintiff to have absolute control of the mine it was operating, till the debts of the mining company were paid. The plaintiff, who was manager of the mine, sued defendant for his services, on the defendant's oral promise to pay him if he would continue in charge of the mine. The court held the defendant was liable on his promise, for, since he was the party who was chiefly interested in and benefitted by the working of the mine, the promise was not within the statute of frauds. The court thought the contract here was not a pure suretyship contract, but involved chiefly the benefit of the surety himself, consequently was not a promise to answer for the debt, default, or miscarriage of another within the meaning of the statute. The principle seems to be that the contract is not within the statute where the guarantor receives so substantial a benefit that he would be unjustly enriched if his promise were not enforceable.

§ 10. **Strict suretyship.** As was previously stated, a strict surety is one who is directly and primarily liable on his contract to the creditor the principal. He is usually a joint obligor with the principal, and the creditor can sue

(5) 141 United States, 479.

him as such. It is no defense to an action brought by the creditor against him that he is only a surety, for, as to the creditor, he is a principal obligor, and is surety only as between himself and his principal. Thus, in the English case of Sison v. Kidman (6) an action in debt was brought against the defendant as maker of a promissory note, and the defendant pleaded that the debt was the debt of another and not his debt, and that there was no consideration for the note as to him. The court held, however, that the plea was not good for it was not a guaranty but the defendant was a principal obligor. When the defendant became a party to the note he entered into an immediate contract with the plaintiff, and the consideration was the money loaned to the other maker.

§ 11. **Common forms of suretyship.** Suretyship may be created by express contract or may arise by operation of law, but the law is the same no matter in what manner created. A grantee of mortgaged land, who assumes the mortgage debt, becomes principal and his grantor his surety for the debt, as between themselves. Likewise, where a lessee who is personally bound to pay rent on his lease assigns the lease, he stands in the position of a surety for the rent as to the assignee of the lease. A similar case of suretyship arises, when a partnership is dissolved and one partner assumes the firm debts. He thereby becomes principal and the other party surety for the debts, as between themselves. Endorsers on promissory notes are sureties as to the makers. Property may stand in the position of surety for a debt, as where a man

(6) 11 Law Journal Reports, Common Pleas, 100.

pledges his property as security for the performance of an obligation of another. Parties may even be placed in the position of sureties against their wills, as for instance where A and B each makes his negotiable note and sends it to C to sell on commission, and C wrongfully pledges the note to D to secure debts due D from him. A and B are in effect sureties for the debt of C, for D, being a bona fide purchaser of the notes, can sue on them while of course the debt secured is the debt of C (7).

§ 12. **Consideration.** A contract of suretyship must be supported by a sufficient consideration. This must consist of some detriment to the provisor. Whatever consideration is sufficient to sustain the promise of a principal will sustain a surety's promise which is concurrent with that of the principal. See Contracts, §§ 40-61, in Volume II. This is true whether the contract be one of guaranty or strict suretyship. When the contract between creditor and principal is induced by the surety's promise to the creditor, the making of such contract is sufficient consideration. However, when the surety's promise is subsequent to the creation of the debt, and the creation of the debt is not an inducement to it, there must be some new consideration or such promise will be void. An agreement by the creditor, to forbear the collection of a debt for a definite time, is a good consideration for a surety's promise (8), as is also an agreement to extend the time of payment (9). Any other consideration suf-

(7) McBride v. Potter, Lovell Co., 169 Massachusetts, 7.
(8) Jackson v. Jackson, 7 Alabama, 791.
(9) Pratt v. Hedden, 121 Massachusetts, 116.

ficient to support a contract may be given to make the surety's promise binding.

§ 13. **Delivery of contract of suretyship.** A contract of suretyship under seal is not executed and complete until delivery of the instrument creating it, and takes effect only from execution and delivery; because the obligation of the surety is to the creditor and not to the principal, and hence the instrument is of no validity until it is delivered to the creditor or his duly authorized agent. The instrument creating the surety's obligation may be delivered by one who is not authorized to deliver it. In such case, if the person who delivers it to the creditor has apparent authority—if the circumstances are such that the delivery is apparently valid and proper, and the creditor has no notice of anything improper to arouse his suspicion, the delivery is valid and the surety liable on such contract. This depends upon principles of estoppel or incidental authority in agency. See Agency, §§ 97, 110-11, 120-21, in Volume II. Thus, where a bond properly executed and signed by a surety is wrongfully delivered to the creditor by the principal debtor, and the creditor has no notice that the delivery was unauthorized, the surety will be bound; for the principal, having the bond properly executed in his possession, and being a proper person to deliver it, would, as to the creditor, have apparent authority to make such delivery (10).

§ 14. **Delivery of an imperfect instrument.** If an instrument, incomplete on its face, is delivered to a creditor, of course a surety on it is not bound, because the creditor

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(10) Belden v. Hurlburt, 94 Wisconsin, 512

has notice that it is incomplete. Sometimes, however, a bond or note is executed by sureties but is not executed by the principal, and is then delivered to the creditor so that nothing irregular appears on the face of it. For instance, when a joint bond is given, signed by two or more sureties but not signed by the principal, the sureties appearing as principal obligors on the bond, it would appear to be a perfect bond. In such case, the sureties are usually held liable on the bond, though not signed by the principal debtor as intended (11) though a number of states hold a contrary rule (12). The states holding the rule as stated consider that, since the sureties executed the bond and permitted it to get into the hands of some party who delivered it, they are therefore more to blame than the creditor or obligee, who with nothing to arouse his suspicion innocently took the bond in good faith and paid value for it. The loss thus falls on the sureties whose lack of care caused the damage.

When a surety signs an instrument with the understanding that the principal is to get one or more additional sureties to sign it, the instrument, if delivered, is binding on him, though no others sign it as sureties. Thus, where A executed his promissory note and induced B to sign as surety, on the promise he would also have C and D sign as sureties, and A then delivered the note to the payee therein named, without having C and D sign as sureties, it was held that B was bound as surety on the note (13). It would be different in a case like the above

(11) Trustees v. Sheik, 119 Illinois, 579.
(12) People v. Hartley, 21 Calif. 585.
(13) Deardorff v. Foresman, 24 Indiana, 481.

if the names of the other proposed securities, C and D, had appeared in the body of the note, for that would have been notice to the payee that it was not properly executed.

§ 15. **Alteration of instrument.** A material alteration of a bond or note, intentionally made by a party having an interest in it after its execution, and without the consent of a surety bound by it, invalidates such instrument as to such surety. Such alteration destroys the contract as made by the surety, and substitutes something else for which he did not agree to be bound as surety. To illustrate, where a man borrowed money on his note for $500 which was endorsed by a friend, and afterwards, without the endorser's consent, raised the amount of the note to $750 in order to secure an additional loan, the note was held entirely invalid as to the endorser (14). If an alteration does not destroy the identity of the contract as made, or does not in any way affect the liability of the surety thereon, such alteration will not release the surety (15). Thus, an additional surety may sign the insrument, for this, of course, has no effect on obligation of the surety who had previously signed. Words which are immaterial may be struck out or put in, without releasing the surety.

§ 16. **Filling blanks in instrument.** If a surety sign a bond or note in blank, and, relying on the good faith of the principal, return it to the principal, he thereby gives the latter apparent authority to fill up the blanks; and, if the principal does fill up the blanks in the instrument,

(14) Batchelder v. White, 80 Virginia, 103.
(15) Bank v. Hyde, 131 Massachusetts, 77.

the surety is liable to an innocent obligee or payee. It would be unjust to allow an innocent holder, who had paid value for an apparently good bond or note, to lose his money by such a negligent act of the surety. It is the surety who relies on the principal to do as he agreed to to do, and he should suffer if the principal acts in bad faith. One executing an instrument, knowing there are blanks in it to be filled up, is liable to innocent transferees, even though the blanks are improperly filled up after he has executed it, and in such cases sureties are responsible for additions made to the instrument without the knowledge of the obligee (16).

§ 17. **Negotiable notes.** The same rule applies to negotiable notes. For instance, when a party to a negotiable note gives it into possession of another for use, with blanks not filled up, such instrument carries on its face implied authority to fill up the blanks necessary to perfect the same. As between such party and an innocent transferee of the note, the former is deemed the agent of the party, who intrusted the note to him, to fill in the blanks necessary to make the note perfect. In an Ohio case the sureties on the note signed it in blank and gave it to the principal, who was to fill in the blank for a certain sum. The principal filled in with a much larger sum than agreed upon and delivered the note to the creditor, who knew nothing of this fact. The creditor, as an innocent holder for value in a suit against the sureties, was permitted to recover the amount of the face of the note (17).

(16) Chicago v. Gage, 95 Illinois, 593.
(17) Fullerton v. Sturges, 4 Ohio State, 529.

The same rule applies when a surety signs the note, delivers it to the principal on condition he get another surety, and the principal forges the name of the second surety.

§ 18. **Estoppel of surety signing instrument.** It is a settled rule of law that a party cannot contradict his own bond or note. He cannot insist that it means something different from what is indicated on its face. Therefore, if one agrees expressly to be bound on a note or bond as principal, and so signs, he is estopped from asserting against the obligee that he is only a surety. Sureties also are estopped from denying facts recited in their obligations, even though such facts are false. Thus, in a Missouri case, a sheriff had made a levy and seized goods of a debtor; and a bond for the delivery of the goods to the creditor, if the court should so order, was given. It was held, since the bond recited that the sheriff had made seizure and levy of the goods, the sureties on such bond were estopped to deny the fact of the seizure and levy or its validity (18).

§ 19. **Estoppel of surety as to other facts.** A surety on an official bond of an officer is estopped to deny the validity of the election or appointment of such officer, in order to avoid liability on such bond. Neither can a surety for a corporation deny the corporate existence of the body for which the bond was given, in order to invalidate such bond. And, in the case of any bond given in the course of legal business, the sureties on such bond will be estopped to deny the jurisdiction of the court in charge

(18) Hanly v. Filbert, 78 Mo. 34.

of the litigation in the course of which the bona was given. It is also true that a surety cannot attack his bond in any collateral proceeding upon the ground that it is void.

§ 20. **Effect of judgment on surety.** A surety is bound by a judgment against his principal to the same exent as the principal. Thus, if a man is surety on a bond for the performance of an obligation by the principal, and a judgment of $1000 is secured against the principal for the improper performance of his obligation, the surety is bound by this judgment. If the effect of the obligation is such that the surety is to be bound by the results of the litigation between others, he is bound by such results, unless there is fraud or collusion on the part of the parties to such litigation. When the bond the surety signs is to indemnify against liability by judgment, a judgment against the principal is conclusive as to the surety.

CHAPTER II.

SURETY'S LIABILITY AND DISCHARGE.

§ 21. **Absence of liability of principal to creditor.** In the absence of fraud or duress on the part of the creditor, a surety is bound on his agreement, even though the obligation of the principal to the creditor is voidable or entirely void and there can be no recovery from the principal. The fact there is no valid claim against the principal does not release the surety. This is well illustrated where there is a surety on a contract made by a married woman, in a state where a married woman is incapable of making a contract. In the case of Kimball v. Newell (1), which arose in New York, a married woman took a lease of a house, and the defendant in the case became her surety for the payment of the rent. A married woman's contract at that time by the law of New York was absolutely void. The landlord sued the surety for the rent due on the premises, and the latter set up the fact that there was no liability on the part of the principal, but the court held this did not release the defendant from his obligation as surety. Such a decision must mean that the surety's promise was that he would do what the principal promised to do, if the principal did not. The law is the same where the principal is not bound because he is

(1) 7 Hill. 116.

an insane person, or an infant, though in these cases the contract is voidable instead of absolutely void. However, where an infant bought land, and, on, reaching his majority, elected to avoid the contract and offered to return the land, his surety was not held liable for the price, because the court said the creditor could get the land back and this extinguished the consideration for the contract (2). In case the performance of a contract by the principal is guaranteed and the creditor fails to perform his part of the contract, there is failure of consideration, and therefore the surety is not liable (3). Other cases of absence of liability of the principal have arisen when a partner executes a bond in the name of the partnership, without authority. In such a case the partnership is not bound by the contract. When a corporation makes a contract which is wholly ultra vires, the corporation is not liable on the contract, yet a surety on it is bound. The principal contract is void because the corporation had no power or capacity to make it. Whether the surety is liable in case of a contract void because it is illegal, depends on the law as to illegality. If the creditor knows of the illegality, the surety is not liable, for the creditor is in pari delicto; but, if the creditor is innocent, the surety can be held to his agreement even though the principal is not liable.

§ 22. **Payment of debt discharges surety.** Payment of the debt discharges the surety. Whenever the principal debtor is released, the surety or co-sureties are also dis-

(2) Baker v. Kennett, 54 Missouri. 82.

(3) Sawyer v. Chambers, 43 Barbour (N. Y.) 622.

charged, and it is immaterial by whom the debt is paid (4). Thus, when the obligation is in the form of a note, and a third party gives the principal money with which to buy the note from the creditor and the principal pays the note with this money, the creditor receiving it as payment, the surety is thereby discharged (5). When the liability of the principal is discharged, that of his surety is also extinguished. The liability of the latter cannot exceed that of the former, except where the principal is discharged by operation of law, as by a discharge in bankruptcy, in which case the surety is not discharged.

§ 23. **Fraud and duress by creditor in securing contract.** A person is not allowed to take advantage of his own misconduct; so, if a creditor secures his contract by means of fraud or duress as to the principal debtor, one who becomes surety for the performance of such contract can set up such fraud or duress against the creditor and escape liability, unless the surety at the time he entered into the contract of suretyship knew of the fraud or duress practiced on the principal debtor. Thus, when the defendant was accommodation endorser of some promissory notes, which were secured by the payee by duress upon the maker, and was sued by the payee, it was held the fraud could be pleaded by the defendant and that the plaintiff could not recover on the notes. The defendant signed the notes without any knowledge that they were secured from the maker by duress (6). In accordance with the rule above stated, if the defendant had

(4) Crawford v. Beall, 21 Maryland, 208.

(5) Eastman v. Plummer, 32 New Hampshire, 238.

(6) Griffith v. Sitgreaves, 81½ Pennsylvania, 378.

known when he indorsed the notes that the creditor had procured their execution by duress as to the principal, there would be no defense available to him, for he became surety of a note knowing the circumstances of their execution, and was not in any way defrauded or deceived by the creditor.

§ 24. **Creditor not bound to press his claim against principal debtor.** The fact the creditor might have recovered the money due him, had he been diligent in pressing his claim against the principal, is no defense to the surety, for the creditor is not obliged to sue the principal. He may wait as long as he pleases before pressing his claim, so long as he does no affirmative act which is prejudicial to the surety's rights. The surety, if he considers the creditor is not diligent enough in pressing his claim, always has the privilege of paying the claim and then proceeding against the principal to secure reimbursement. In an Illinois case, a surety on a promissory note filed a bill in equity to enjoin a suit against him, brought by the holder of the note, alleging that the principal was deceased, that the owner of the note had neglected to file his claim against the principal's estate within two years, so that his right was bared as to the principal's estate; and claiming that the surety was thereby discharged. The court held, however, that there is no duty of active diligence incumbent on the creditor in such a case, and all the surety has a right to require is that the creditor does no affirmative act that will operate to his prejudice. It is the duty of the surety to see that the principal pays (7).

(7) Villars v. Palmer, 67 Illinois, 204.

In this case the obligation as to the principal's estate was completely barred by a statute of limitations, but this fact did not affect the surety's liability. The same rule is generally applied when a surety, after making a contract, moves to another state; and is sued there after the statue of limitations has run against the principal in the state where the contract was made. As a rule the statute of limitations stops running against a party while he is out of the state. The surety being out of the state the statute does not run as to him and he still remains liable, though the principal has a good defense. There is some authority, however, that when the right is barred as to the principal the surety is no longer liable. Likewise, the surety remains liable when the right against the principal is suspended, because of war between his country and the country in which the surety resides, as is shown by a Maryland case where the surety had to pay interest on the debt of a British subject during the Revolutionary war (8).

§ 25. **Effect of acts of creditor due to fraud or judicial error.** If the creditor accepts payment from the principal, and the payment proves to be made in fraud of creditors of the principal so that the creditor is forced to return it, he may still proceed against the surety, unless he knew the payment was fraudulently made; for the creditor has to accept payment when offered, and no act of his injures the surety in such case. The rule is the same where the creditor gives up the original note or bond and takes in its stead a forged note or bond, not knowing of

(8) Paul v. Christie, 4 Harris and McHenry, 161.

the forgery. In such cases, since the creditor is innocent of the wrong of the principal, any injury to the surety is through no fault of his. Where a creditor gets a judgment against a surety, and later sues the principal and loses in his suit against the principal; the surety, it is held, may have the judgment against him set aside, because he is no longer liable when the principal is released by a judicial decision (9). This, however, it seems should not be true, where the defense the principal set up in the suit brought by the creditor against him was one not available to the surety, as, for instance, the defense of infancy or ultra vires; for, as we saw in a preceding section (10) the fact there is no valid principal obligation does not release the surety.

§ 26. Discharge of surety by affirmative act of creditor. It is well settled law that when the creditor does an affirmative act which prejudices any right of the surety, the surety is thereby released from his obligation to the creditor. It may be well briefly to state some of the rights of the surety, before proceeding to discuss how such rights may be prejudiced by acts of the creditor. It is apparent that the surety's contract is made for the benefit of the principal debtor, and therefore the principal debtor is bound to see that his surety suffers no loss; and, though there be no express promise on the part of the principal to indemnify the surety for any loss he may suffer, the law implies such an obligation. The surety then can sue the principal at law for any damage he may suffer. Be-

(9) Ames v. Maclay, 14 Iowa, 281.
(10) See § 21, above.

sides this right at law, the surety is also in equity entitled to be subrogated to whatever rights the creditor has against the principal, and can thus get the benefit of any security which the creditor may have for his debt. In addition to his right of indemnity and of subrogation, where there are co-sureties he has a right of contribution from them. These rights of the surety will be taken up more fully in the next chapter (11) to which the reader is referred for a more detailed explanation. If the surety can show that any of these rights in respect to the principal or in respect to any co-surety have been prejudiced by the act of the creditor, he will have a good defense to an action by the creditor against him as surety; and, if his rights as to a portion of the debt only have been so injured, he will have a defense as to such portion. An idea of what constitutes an injury to the surety's rights can best be obtained by taking up a few of the cases on the subject. It may be well to state here that the question is not whether the surety is actually damaged by the act of the creditor or not, but whether there is a possibility that he might suffer damage.

§ 27. **Extending time of payment.** The creditor has no right to extend the time of payment of the debt without the surety's consent, and any such extension, even for a few days and even though it appears to be beneficial to the surety, releases the surety from his obligation. In a leading case on this point, a guarantor brought a bill in equity to cancel his guaranty, because the creditor gave the principal additional time to pay for the goods fur-

(11) See chapter III, sections 1, 2, and 3.

nished him, the payment of which was guaranteed by the complainant. Lord Eldon, one of the most eminent English chancellors, decided that the guaranty should be cancelled, for the creditor had no right to extend the time of payment without the consent of the guarantor (12). In such a case, the only right of the surety affected is his right of subrogation. If the time is extended a month, for instance, and the surety pays the creditor as soon as the debt matures under the terms of the original contract, as he has a right to do, he cannot enforce the right of the creditor against the principal until the expiration of one month, thus delaying his right of subrogation for that period. This slight interference with the surety's right of subrogation is enough to discharge his liability to the creditor.

§ 28. **When suretyship relation is created by agreement among obligors.** Several parties may be bound as joint debtors and by agreement arrange that one of them is to assume the debt, thus making him the principal debtor as between the joint obligors. The liability of all these joint obligors to the creditor remains the same, and, until he knows that relation of principal and surety has been created among them by agreement, he cannot be affected by it. But when a creditor knows one of several joint obligors, by agreement with the others, has become primarily liable and the others sureties for him, the rules of the preceding subsection apply; and, if the creditor extends the time of payment to the one who assumes the debt, the others will be thereby released. Thus, a part-

(12) Samnell v. Howarth, 3 Merivale, 272.

nership owed some debts and one partner withdrew from the firm, the other partners assuming all the firm debts. The new firm became bankrupt and the creditors of the old firm sued the retired partner, who pleaded that the creditors, knowing the new firm had assumed the debts, had extended time of payment to the new firm without his consent. The court held his liability as surety was discharged (13). Cases similar to this, where the creditor has no part in the creation of the suretyship relation, arise where a purchaser of mortgaged land assumes the mortgage debt, or where a leasehold is assigned, the assignee in both cases being the principal debtor—the one primarily liable for the debt—and the assignor the surety. If a transferee of mortgaged land does not assume the debt, the land is primarily liable, that is, is in the position of principal, while the grantor is surety. In such a case, an extension of time to the grantee of the land to pay off the debt discharges the grantor from liability (14). It suspends for a time the surety's right to pay the debt when due and then enforce the creditor's mortgage on the land.

§ 29. **Creditor taking forged or illegal note.** When the creditor, without the surety's knowledge, takes a new note which is forged and surrenders the old note, the surety is not released if the creditor did not know that the new note was forged (15); perhaps because the creditor took the invalid note innocently by mistake, and the rights of the surety were not really prejudiced. But,

(13) Rouse v. Bradford Banking Co., [1894] Appeal Cases, 586.
(14) Murray v. Marshall, 94 New York, 611.
(15) Hubbard v. Hart, 71 Iowa, 668.

even here, if the surety knew a new note had been given but did not know it was forged, and, thinking he was discharged, did not make any move to assert his right, he would be discharged. A note, illegal because usurious, taken by the creditor in exchange for the old note, releases the surety on the old note because, in this case, the creditor must have notice of the illegality (16). As a general rule we may say, that, when a creditor takes a new bond or note from the principal in exchange for the old one, a surety on the old instrument is discharged, if the new note or bond proves to be void or illegal and the creditor knew or should have known this fact; but not if the creditor acted in good faith and innocently. In the latter case, though he did an affirmative act prejudicial to the surety, he did it innocently.

§ 30. **Principal's set-off or counter claim against creditor as a defense to surety.** The surety cannot use a set-off or counter claim of the principal in a suit by the creditor against the surety alone, because such set-off or counter claim belongs to the principal and cannot be used in a suit to which the principal is not a party. This was decided in a case where the surety was sued on a note, and set up as a defense that the note was given by the principal in payment of some timber, the quality of which was so misrepresented by the creditor that the damages suffered by the principal therefrom amounted to more than the amount of the note. The court held that, since the debtor was not a party to the suit, the surety could not elect for him to set up this claim for breach of guaranty

(16) Moulton v. Posten, 52 Wisconsin, 169.

against the creditor, and judgment must be for the creditor. Such claim for breach of guaranty belonged to the principal, and he had the sole right to decide whether to enforce it or not (17). While the principal's set-off or counter claim cannot be set up by the surety at law without consent of the principal, it is a good defense in equity, where the principal is made a party to the suit, for all the parties concerned are before the court, and the creditor is seeking to recover from the surety a debt the principal ought to pay. Therefore, any claim which the principal has against the creditor can be raised and used for the benefit of the surety. Equity will, by its decree, deduct the set-off or counter claim due the principal from the amount due the creditor, and enforce payment of any balance remaining from the principal, if possible; and, if not, then from the surety.

§ 31. **Surrender of securities by creditor.** When a creditor has any security of the principal for the debt due him, he cannot release such security without discharging a surety for the debt, to the extent of the value of the security released. A release of the security is an act of the creditor which prejudices the right of subrogation of the surety; for, as we have seen, the surety is entitled to be subrogated to all the creditor's rights against the principal, and, by release of a security, the surety plainly loses his right to be subrogated to the creditor's right to that security, and may possibly be injured to the extent of the value thereof. The value of the security taken is usually its value at the time it was released. In Dunn v. Parsons

(17) Gillespie v. Torrance, 25 New York, 306.

(18), a New York case, the defendant was sued as surety on a note, and set up that the plaintiff had released a judgment against the makers of the note, which was a lien on certain real estate belonging to the makers. The court held the defendant was thereby released, to the extent of the value of the lien released by the plaintiff. The doctrine of this case applies to releases of any sort of security, and also to a loss of securities through the neglect of the creditor, as where he takes property of the principal as pledgee and does not take reasonable care of it, so that it is destroyed or injured; or where he holds in his possession the promissory notes of third parties which belong to the principal, and fails to take necessary steps to hold endorsees. But where the creditor holds some lien against property of the principal, his neglect to enforce it does not release the surety; for it is the surety's duty to pay the debt and enforce the lien, if he desires the benefit of it (19). Such a lien is the property of the creditor and not property of the principal placed in the creditor's possession, as in the other cases mentioned above.

§ 32. Same: Reasonable conduct of creditor. There is one limitation on the doctrine that a release of a security against the principal releases the surety pro tanto. When the creditor surrenders the security as a part of a reasonable business move, the surety is not discharged. The creditor may, therefore, exchange one security for an equivalent one, or he may compromise a disputed claim, or give up or surrender a security of no value. The surety

(18) Dunn v. Parsons, 40 Hun (N. Y.) 77.
(19) Fuller v. Tomlinson Brothers, 58 Iowa, 111.

is not in any way injured by such acts of the creditor. For instance, the principal in a certain case gave his creditor a policy of insurance, as security for a debt due the latter. The principal became bankrupt so that he could no longer pay the premiums on the policy, and the creditor surrendered the policy to the insurance company for what he could get for it. It was held the surety was not thereby released, for the creditor was not bound to pay the premiums on the policy and did the best he could with it (20). Perhaps, in this case, had the creditor allowed the policy to lapse, he might have released the surety to the extent of the surrender value, because his negligence would have caused the loss of the surrender value of the policy. If a creditor misappropriates, sells at a sacrifice, or otherwise prejudices the surety by his misconduct in dealing with property in his hands as security, he releases the surety to the extent of the damage done by such misconduct. He cannot wantonly destroy property he holds as security, and then recover the full amount of the debt from the surety.

§ 33. **Taking property by attachment and execution.** The creditor can acquire possession of the property of the principal by attachment or by levy of execution. He need not attach or make a levy, but, if he does so and acquires possession of the debtor's property, he should not afterwards in any manner relinquish the same or consent to a course of proceedings that will have that effect. If he does so, the surety will be discharged to the extent of the value of the property thus released (21). In the case of attach-

(20) Coates v. Coates, 33 Beavan, 249.
(21) Maquoketa v. Willey, 35 Iowa, 323.

ment, since the risk to the creditor in enforcing the proceeding is so great, many states hold the creditor may release such attachment without discharging the surety. Where an execution becomes a lien on the property of the debtor as soon as issued and before any levy is made, the surety is released if the creditor abandons the proceedings. The extent of the surety's release will be the amount which would have been realized by levy and sale of the property.

In the absence of statute, the fact a principal has become insolvent and received a discharge from all indebtedness in a court of bankruptcy does not discharge his surety; so, when an attachment lien is destroyed because the principal has gone through bankruptcy, the surety is still liable. Also a levy of execution on or an attachment of property of no value, the sale of which would bring no return, may be abandoned without release of the surety (22).

§ 34. Tender of payment by principal debtor discharges surety. When the debt is due, if the principal debtor tenders payment and the creditor refuses, this discharges the surety, for the creditor ought to receive the money due him when it is offered. Likewise, if the surety tenders payment and his tender is refused, he is discharged from further liability and so are his co-sureties, if there are any (23). Such tender does not have to be kept good nor paid into court, for the creditor is bound to receive the money, if offered after it is due, and refusal to do so in-

(22) Moss v. Pittenger, 3 Minnesota, 217.
(23) Hayes v. Joseph, 26 Cal. 535.

jures the rights of the surety and completely releases him, though of course the creditor can still sue the principal debtor for the debt.

§ 35. **Failure of creditor to apply money in his control to debt.** When a bank is a creditor, and the principal debtor has enough money on deposit to pay the debt when it matures, the fact that the bank does not apply the money on deposit to the payment of the debt will not discharge a surety for such debt. The bank is not bound to apply such money to the payment of the debt, although under its general banker's lien it would have a right to do so (24). But it is held that if the principal makes a note payable at a bank, and, when the note matures the bank is holder of the note and has enough of the debtor's money on deposit to pay it, an endorser or other surety will be discharged if the bank does not honor the note. If the balance of the debtor in the bank is not large enough to pay the debt, the bank is not obliged to use what is there as part payment, however, for a creditor is not bound to accept a part payment of a debt.

§ 36. **Effect of creditor's failure to sue at surety's request.** At common law in most states, though the surety specially requests the creditor to sue the principal and the latter fails to do so, this does not release the surety. The creditor need not sue if he does not wish to, it being the surety's duty to pay the debt and sue the principal himself. The surety is not put to any hazard by the forbearance of the creditor, as he has it in his power to protect himself. However, if the delay in enforcing the debt is

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(24) **National Bank v. Smith, 66 New York, 271.**

due to fraudulent connivance between the creditor and principal, or if there is an agreement for a definite extension on a new consideration, the surety will be released. But where the creditor has started a suit against the principal, the surety will not be discharged by the creditor's act in agreeing to continue the suit against the principal, unless the surety is actually prejudiced thereby. A few states, however, hold at common law that if the surety, after maturity of the debt, specially requests the creditor to sue the principal and he neglects to do so, the surety is thereby discharged (25); and this has been enacted by statute in a number of other states whose common-law rule was otherwise.

§ 37. Notice to guarantor of default of principal. The guarantor of an obligation as a rule is not entitled to notice of the principal debtor's default, because he did not contract for such notice. Thus, where the defendant in a suit was sued for rent, the payment of which he had guaranteed, the court held that the fact he was given no notice the rent was not paid was no defense, for it was his duty to take cognizance of the default of the principal debtor (26). There is an exception to this rule where the time and place of payment are indefinite. In such case the guarantor is entitled to notice of the principal's default, for otherwise he cannot pay the debt if he so desires, because he does not know when it is due or where it is payable. In general, the guarantor is entitled to notice, when it would be very difficult for him to discover the time and

(25) Pain v. Packard, 13 Johnson (N. Y.) 174.
(26) Brookbank v. Taylor, Croke, James, 585.

place of payment and easy for the creditor to give notice of these facts.

§ 38. **Notice to guarantor of acceptance of guaranty.** When a person offers to guarantee the payment of goods to be sold, or credit given to another, there is conflict of authority as to whether notice must be given by the creditor to the guarantor that he accepts the guaranty. In the case of Davis v. Wells (27) the defendant's written guaranty stated that the defendant guaranteed any indebtedness of a certain firm to the extent of $10,000 for any overdrafts then made, or that might be made in the future. This writing was sent to the plaintiff, who thereupon gave credit to the firm named in the guaranty, but never gave the defendant notice that they had accepted the guaranty and given such credit in reliance on it. Notice of the amount of the firm's indebtedness was given to the defendant the day before the suit. The court here said that, when a guaranty was sent to the creditor, acceptance was required from him to make a valid contract, and he must give notice that he has accepted, but in this case the guaranty showed on its face it was made at request of the plaintiff, and therefore the contract was complete. If the guaranty is at the request of the creditor, the contract is complete; for it is in effect an offer by the creditor to accept the party as guarantor, which is accepted by the latter. When not at the creditor's request, the cases are hopelessly in conflict as to whether he must give the guarantor notice when he accepts the guarantee. If the guaranty is in the form of an offer requiring a counter promise to the offeror, then

(27) 104 United States, 159.

it would seem that some notice of acceptance should be given in order to complete the contract. If in the form of an offer to guaranty, "if goods are sold," thus calling for an act instead of a counter-promise, the contract seems completed when goods are sold, upon the principle of a unilateral contract. If further notice is required it is due to a requirement of the law of suretyship and not of contracts. See Contracts, § 22, in Volume II.

§ 39. Alteration of principal's contract. The general rule of law is that a material alteration of the principal debtor's contract, without the consent of the surety, will release the surety, if such alteration might possibly prejudice any of his rights. By alteration here is meant any change made with apparent intent to affect the terms of the contract. An alteration made by any party discharges the surety, when made without his consent, for after such alteration the deed is not the deed which he signed. Thus, where the principal to a promissory note changed or erased the word "September" and put in the word "October," without the knowledge or consent of either creditor or surety, the Supreme Court of the United States held that the surety was discharged (28). An alteration made by a stranger to the instrument does not release a surety to it, and the same is true when the change is made by accident or mistake. An immaterial alteration, of course, does not release the surety, as it cannot in any way prove prejudicial to him. If there is an alteration in a note by changing the place of payment the surety is discharged, unless he consents. It is the duty of the maker to seek the payee at

(28) Wood v. Steele, 6 Wallace, 80.

the place where the note is payable, and it is likewise the duty of the surety to see that the debt is paid; and, if the place of payment is changed, his duty may thereby be increased, for it may require greater effort to find the payee.

§ 40. Same: By agreement between creditor and principal. A material change in the contract by agreement between creditor and principal releases the surety to the extent to which he might possibly be injured. In an English case, the plaintiff had rented the milking of thirty cows to the principal, and the defendant guaranteed payment of the rent. By a later agreement between the plaintiff and the principal, thirty-two cows were furnished part of the time and twenty-eight for the rest of the time. This it was held discharged the defendant as surety (29). In this case, it should be noted, an entirely new contract was substituted for the old one. In such case the surety is released, regardless of whether he might be prejudiced or not. Where a slight change is made in the old contract, then the question whether he might be prejudiced must be determined.

If the change in the contract is such that it is apparent it could not injure the surety, then he will not be released from liability. To illustrate, suppose the maker of a promissory note is to pay seven per cent. interest, and later by agreement it is written on the note that the rate of interest henceforth is to be six per cent. Clearly, no right of a surety on such a note would be prejudiced, for it would merely amount to a release by the creditor of a part of his rights on the note and would be beneficial to the surety

(29) Witcher v. Hall, 5 Barnwell and Cresswell, 269.

(30). Likewise, the creditor and principal may agree to reduce the amount of the debt, or that the creditor shall furnish more goods for the amount guaranteed than had been previously agreed upon. Such changes, which it is evident could by no possibility injure the surety, but must prove beneficial to him, do not discharge him; but in such cases it must be apparent that there is no possibility that his rights will be injured.

§ 41. Non-disclosure of facts creditor should reveal to surety. Facts of an unusual nature which the surety is not likely to discover, which are known to the creditor but unknown to the surety, and which are of such a nature as to impose greater risk on the surety, should be disclosed to him by the creditor on making the contract of suretyship. If the facts are such that the surety would probably not have entered into the contract had he known them, he will be discharged if such facts are concealed from him. Thus, an agreement between the principal and the creditor, that the creditor is to charge the principal more than market price for goods, must be disclosed to a surety for the payment of the goods (31); and where the creditor concealed from the surety on the bond of an employee, that the employee had previously been guilty of fraudulent misconduct while in the creditor's employ, it was held the jury might properly find the surety discharged, and, if the fact should have been disclosed by the creditor, his motive in not revealing it to the surety was immaterial (32). Also, when the surety signed the bond of a state treasurer when

(30) Cambridge Savings Bank v. Hyde, 131 Massachusetts, 77.
(31) Pidcock v. Bishop, 3 B. & C. 605.
(32) Railton v. Mathews, 10 Clark & Finnelly, 934.

the treasurer had already embezzled funds, and this was known to the state officer at the time the surety signed, concealment of such facts was held to release the surety (33). The creditor need not disclose all the facts he knows, and it is not easy to tell just what facts he must disclose; except that we may say that, if he is pretty certain the surety will not enter into the contract if he knows certain facts and yet he intentionally conceals them, the surety will be released, for this is like a fraudulent concealment. Thus, the mere fact that the creditor knew that his employee, a collection agent whose bond the surety was about to sign, had failed to remit money collected for some time, does not impose on the creditor the obligation to inform the surety; but if the creditor knew such employee had embezzled the money, such fact would have to be revealed.

§ 42. **Creditor not bound to discover facts.** The creditor, however, is not bound to make any effort to find out facts concerning the principal, and the surety will not be discharged where the creditor was ignorant of the facts complained of, even though he was grossly negligent in not knowing them. As to facts which need not be disclosed, it has been held that the fact the principal's brother had been surety and a new surety was substituted for the brother need not be disclosed to such new surety. Also, irregularities or omission of duty on the part of a bank cashier, which did not affect his official integrity, need not be disclosed; for facts which must be disclosed must have a bearing on the question whether the principal will be likely or able to perform the obligation (34).

(33) Sooy v. New Jersey, 39 New Jersey Law, 135.
(34) Bostwick v. Van Voorhis, 91 New York, 353.

§ 43. **Information requested by surety.** If the surety asks the creditor for information as to the subject matter of the proposed suretyship, the creditor must, if he answers at all, make a full disclosure of everything within his knowledge that would tend to influence the decision of the surety to sign or not to sign the contract. He must disclose all facts, including those he might have concealed had no inquiry been made. He may refuse to answer at all, if he so desires; but, as a practical matter, such refusal would probably cause the proposed surety at once to refuse to enter into the obligation.

§ 44. **Retention of principal in employment after knowledge of dishonesty.** When a surety signs a bond guaranteeing the integrity of a principal while in service of the obligee, the obligee is bound to discharge the principal from his employment as soon as he discovers any dishonesty of the principal, or the surety will be discharged as to all defaults arising after the obligee obtains such knowledge; or else the obligee must immediately notify the surety of such dishonesty of the principal and obtain from him a waiver. It is a breach of good faith for the employer or obligee to continue the servant in a place of trust after discovering his dishonesty or defalcation, which is presumptively and in fact unknown to the surety, without notifying the surety of the fact and thus giving him an opportunity to elect whether he will continue the risk. When there is misconduct or negligence but no fraud and dishonesty on the part of the principal, the surety is not released if not notified of such misconduct. Thus, where the defendants in a suit on a bond were sureties for the integrity

of an employee of the plaintiff's corporation, they set up in defense of the suit that the principal had not rendered monthly accounts and paid the balance due each month as required by the plaintiff's corporate by-laws. The principal had not paid the balance due from him for a long time, and had finally died insolvent owing a large sum to the plaintiff, for the recovery of which suit was brought against the sureties. The court held the defendants were not released; saying that where there is no fraud or dishonesty on the part of the principal, which is known to the plaintiff, mere inaction on the part of the plaintiff will not discharge the defendant from liability (35).

§ 45. **Negligence in not discovering dishonesty. Collateral misconduct.** If the dishonesty of the principal is not known to the obligee, the surety continues liable for subsequent defaults of the principal, even though the obligee be grossly negligent in not knowing of the dishonesty. Retention of the principal in service, after knowledge of his immorality in matters foreign to the subject matter of the suretyship, does not release the surety. Only those things which have an actual bearing on the employer's integrity or his probable ability to meet the obligation need be disclosed. The fact the employer discovered his employee was an adulterer would have no bearing on the latter's financial integrity.

§ 46. **Misconduct of principal towards surety.** In general, fraud or other misconduct of the principal toward the surety does not discharge the latter, where the creditor is ignorant of such fraud or misconduct. A surety

(35) Watertown Fire Insurance Co. v. Simmons, 131 Massachusetts, 85.

may sign upon the understanding with the principal that certain conditions are to be performed before he shall become liable; if the creditor does not have notice of such conditions the surety is bound though they are not fulfilled. The creditor is perfectly innocent in such cases, as he does not know what arrangements there may be between principal and surety. The surety, on the other hand, while innocent of any wrongdoing, has, nevertheless, by allowing the principal to have some apparently perfect note or other instrument, placed him in a situation where he can mislead the creditor. In a leading case on this point, a surety signed a negotiable note on condition that the principal was to get a certain other man to sign as surety. The principal got a different person to sign as surety and delivered the note to the payee for value without notice of these facts. The payee sued the surety on the note and the above facts were set up in defense to the suit. It was held that since the surety had placed an apparently complete note in the hands of the principal—the proper person to deliver it to the payee—the latter, who took it in good faith for value without notice of the condition, could enforce the note against the surety (36). The surety in the above case also claimed that there was an alteration of the note because another surety had signed it, but the court held that before delivery of the note the principal had implied authority to secure additional sureties. Securing a new surety would clearly not prejudice one who was already surety on the note. The doctrine of the above case applies where the

(36) Ward v. Hackett, 30 Minnesota, 150.

principal, to induce the surety to sign, forged the name of another surety to the instrument. Such forgery does not release the surety as against a bona fide holder for value (37).

§ 47. Same (continued). In a New York case (38), there is another illustration of when the surety may be held liable for loss caused by the dishonesty of the principal. The surety raised a sum of money to pay the note on which he was surety, and gave the money to the principal to give to the creditor. The principal paid this money to the creditor, but owed the creditor on another note and did not tell him which note to apply this money on. The creditor applied it on the note on which there was no surety, and, when he sued the surety on the first note, the court held the latter was still liable, for the creditor got the money without qualification from his debtor and could apply it to either note. In all these cases the surety has entrusted something to the principal and the latter has used it wrongfully, but had apparent authority to do as he did with it. As between the creditor and the surety the latter must bear the loss. Not only is the surety liable to an innocent holder, when he entrusts an instrument to the principal who delivers it contrary to agreement, but the surety is liable if he intrusts it to a stranger who misdelivers it. In either case the instrument got into circulation by the act of the surety and he is liable to one who took it bona fide without notice and paid value for it.

§ 48. Same: Constructive notice to surety. If an instrument on its face shows that it is not complete, then the

(37) Stoner v. Millikin, 85 Illinois, 218.
(38) Harding v. Tifft, 75 New York, 461.

creditor cannot hold the surety, because the irregularity on the face of the instrument should put him on his guard. Thus, if there is a co-surety named in the body of the instrument, but no signatures appear on the note, this is constructive notice of a conditional delivery to the principal by the surety who did sign it. Absence of the principal's signature, by weight of authority, raises the presumption that the surety who has signed does not mean to be bound unless the principal signs also.

§ 49. **Dealings or relations between creditor and co-surety.** A surety, if he pays the debt, has a right to have any co-sureties contribute their proportions of the sum he paid, and can enforce this right of contribution against them. If A, B, and C are co-sureties and A pays the entire debt, he is entitled to recover one-third the amount he paid from each of the co-sureties, B and C. Furthermore, in order to enforce this right of contribution, a surety has a right to be subrogated to any right which the creditor has against the co-surety. Any act of the creditor, or any dealing between creditor and one surety, will release any co-surety to the extent to which he might possibly be prejudiced by such act of the creditor. Any such act by the creditor, as to one surety, releases co-sureties, just as an act in respect to the principal debtor's obligation will release sureties. It should be noted, however, that, since a surety's right against his co-surety is to recover contribution, he can be released only to the extent of the amount he might be entitled to recover from co-sureties if he paid the debt. In a Louisiana case (39)

(39) Gosserand v. Lacour, 8 Louisiana Annual, 75.

a creditor extended the time of payment as to one of three sureties for a debt. Later he sued one of the other sureties, who set up as a defense that the creditor had extended the time as to a co-surety. The court held this was a good defense, and he was released to the extent of his right of contribution, here one-third of the entire debt.

§ 50. **Release of co-surety with reservation of rights against the others.** A creditor, however, may agree with one co-surety that he will not sue him on his suretyship obligation, but will reserve his rights against the other co-sureties. In such case the other co-sureties will not be released (40), for this is interpreted, not as a release, but as a covenant not to sue the surety with whom the agreement is made. No right of the co-surety is affected by such an agreement made by the creditor. The co-surety may pay the debt and enforce his right of contribution the same as before such agreement was made. For instance, suppose A and B are sureties for a debt and the creditor agrees with A that he will not sue him but will reserve his right to sue B. Suppose the creditor then sues B, who, being liable for the whole debt, has to pay it. B has a right of contribution against A and can sue A and recover one-half of the amount he paid. A covenant not to sue A would therefore be of little value to him. Likewise, a creditor may release one surety from his proportion of the debt, reserving his right against the co-surety for his proportion. Clearly this could not injure the latter, for he actually would be released as to all but his own proportion of the debt.

(40) Thompson v. Lack, 3 Common Bench Reports, 540.

§ 51. **Effect of discharge of co-surety in bankruptcy.** When there are several sureties for a debt and one becomes bankrupt, the remaining sureties are liable for the entire debt; and, after paying it, can proceed to collect what they can get from the insolvent estate. Suppose A, B, C, and D are co-sureties for a debt of $1,200. If all are solvent each is liable for one-fourth, or $300; that is, any one can pay the debt and recover $300 from each of the other three. If A and B become insolvent, then C and D are liable for $600 each; and, if they pay, must get what contribution they can from the estates of A and B. The fact the creditor proves his claim against a bankrupt surety and gets a dividend does not discharge co-sureties, except that the debt is paid to the extent of the dividend received (41).

§ 52. **Effect of accident and mistake.** If a bond or other written instrument be destroyed or lost through some accident, so that a suit cannot be maintained on it at law, recovery can be had in equity. A surety on such an obligation is not discharged because of the loss of the instrument, though one of the surety's rights is injured, namely, his right to be subrogated to the creditor's right to sue at law on the instrument, because an action at law cannot be maintained on a lost instrument. However, this was not due to any fault of the creditor. The rule would be otherwise if the creditor deliberately destroyed the instrument. If he did this he could not recover, even from the principal.

If by mistake the instrument signed by the surety fails

(41) Ex parte Gifford, 6 Vesey, 805.

to express the agreement the parties intended it to express, so that at law the surety is either not liable at all or is liable in a mode not intended, the instrument may be reformed by a court of equity and the surety held on it according to the terms of the agreement as intended, although such reformation clearly binds him in a way he was not bound before reformation was decreed. Equity corrects such errors to prevent gross injustice, though it is clearly changing a contract or forcing a liability on the surety which he did not actually assume, though he did in fact intend to assume it. See Equity Jurisdiction, Chapter VI, in Volume VII of this work.

§ 53. **Assurance or promise of creditor that he will look to principal only.** An oral assurance made by the creditor to the surety after the debt is due, that he will look to the principal only for payment, will discharge the surety, if, relying thereon, he omits to pay the debt or fails to secure himself, and thus changes his position in respect to the obligation to his actual detriment (42). Thus, he may surrender to the principal securities, or be otherwise misled to his disadvantage. But a bare statement by the creditor that the principal's responsibility is sufficient security for the debt, or that he will not look to the surety, standing alone, will not estop the creditor from recovering from the surety, unless the surety was actually misled to his disadvantage by reason of such statement. Ordinarily the law regards such statements as mere expressions of opinion or intention, which neither invite confidence, nor is confidence likely to be reposed in them.

(42) West v. Brison, 99 Missouri, 684.

They are not binding as contracts for want of a consideration.

A release of the surety by the creditor of course has no effect on the liability of the principal debtor, but he still remains liable for the entire debt. His liability is in no way changed by release of the surety. A surety may even buy from the creditor his release from the obligation, leaving that of the principal intact (43).

§ 54. **Creditor informing surety that debt is paid.** When the creditor gives notice to the surety that the debt has been paid, and the surety in consequence changes his situation by surrendering securities or forbearing to obtain securities, or has otherwise sustained loss, the surety is discharged, though in fact the debt was not paid, and such notice was given by mistake and without fraudulent intent. If there is a mistake it is at the peril of the creditor and he will not be heard to complain (44).

§ 55. **Notice of revocation.** The general rule is that a surety or guarantor cannot relieve himself from future liability by serving notice on the obligee that henceforth he refuses to be liable, unless he has a stipulation in the contract providing that he may give such notice. Thus, in a Pennsylvania case (45) a surety for rent on a lease for a term of years served notice on the lessor that he would not be liable for rent in the future, but the court held he could not revoke his obligation by merely serving notice. He has made a definite legal contract which he has no right to break. A simple guaranty for a proposed loan,

(43) McIlhenney v. Blum, 68 Texas, 197.

(44) Baker v. Briggs, 8 Pickering (Mass.) 122.

(45) Coe v. Vogdes, 71 Pennsylvania State, 383.

however, may be revoked by the guarantor before the proposed guaranty has been acted on, for, until acted upon, it is only an offer to guaranty. There is no contract entered into in such a case when the notice is given. Where a surety has stipulated that he may terminate his liability by giving notice to the creditor, after he has given such notice he is not liable for subsequent acts or defaults of the principal.

If a surety guarantees the performance of a contract by a certain date, and the principal gets into default before that date, the surety can, if he so desires, give notice to the creditor to stop performing the contract; and he will not be liable for additional damages due to continued performance, but will be liable for whatever damages are due on the whole contract taken as if performance was stopped at the time notice was given (46). This is because when one party to a contract stops performance, the other cannot continue performance and pile up the damages, but the damages are estimated at the loss which would be occasioned if the performance stopped at that point.

§ 56. **Death of surety.** Death of the surety does not ordinarily terminate his contract, and if defaults occur after death his estate is liable. Thus, a surety on a cost bond died, after his death there was a default on the bond, and suit was brought against his estate. The court held that the death of the surety did not revoke his obligation as surety, but his estate continued liable as surety for de-

(46) Hunt v. Roberts, 45 New York, 691.

faults occurring after his death (47). Whenever the undertaking of the surety is for a definite period, as when it is for an officer's conduct during his term of office, or for the repayment of advances made to the principal during a stated period, the estate of the surety is liable for any defaults occurring after his death; this is especially so when the surety binds his "heirs, executors, and administrators" for the performance of his undertaking.

§ 57. **Same: Joint obligations.** The old common law rule was that discharge of one joint obligor discharged all joint obligors; and, furthermore, if one of several joint obligors died, his obligation died with him and could not be enforced against his estate. Now, however, statutes usually provide that joint obligations shall be deemed joint and several, and under these statutes the estate of a deceased joint obligor is chargeable with the liability. It is the rule, however, in the absence of statute, that in case of purely joint obligations of sureties, if one of the joint obligors dies his personal representatives are discharged and the obligee can sue only the surviving obligors. Apart from statute, where the estate of the deceased joint obligor received some financial benefit from the obligation, courts of equity took jurisdiction and enforced the obligation against his representative (48). This was because the estate of the obligor had received something which it would be unjust to allow it to keep without paying value therefor. But the mere joint obligation of a deceased surety without benefit to his estate,

(47) Fewlass v. Keeshan, 88 Federal, 573.

(48) Boskin v. Andrews, 87 New York, 387.

is not sufficient to create such an equity against his estate. His estate cannot be held liable in equity unless there is some moral obligation antecedent to the bond, and such a moral obligation cannot exist when the deceased was a mere surety and received no benefit (49).

(49) United States v. Price, 9 Howard, 90.

CHAPTER III.

REMEDIES OF SURETY.

SECTION 1. SUBROGATION.

§ 58. **Subrogation of surety to creditor's rights.** Subrogation is an equitable right which a party, who pays money at the request of or for the benefit of another, has to stand in the shoes of the creditor and enforce the latter's rights against the party benefited. Under certain circumstances, the surety, after he has paid the debt of the principal, may be subrogated to the creditor's rights against the principal debtor. He cannot enforce his right of subrogation before paying the debt, as this would tend to injure the creditor. He may be subrogated to all the creditor's securities, equities, liens, remedies, and priorities against the principal, and is entitled to enforce them against the principal in a court of equity. The right is one given by equity and is independent of any contract. The surety ordinarily can exercise it only after he has paid the entire debt. As we have seen in the preceding chapter, the creditor must take care not to injure the surety's rights by any affirmative act, and any act of his which injures them will release the surety from liability. Hence any release of securities or extension of time will either destroy or suspend the surety's right of subrogation, in part at least.

§ 59. **Securities to which surety is entitled.** In general the surety, in equity, is entitled to the benefit of securities which the creditor holds against the principal pertaining to the debt for which he is surety. The debt must be identical and the securities must be those pledged for the debt by the principal debtor, or for his benefit, or the surety is not entitled to be subrogated to them. Thus, when the surety is surety for a partnership and also for one of the individual partners, he cannot be subrogated to the securities given for a partnership debt by the firm, by reason of his having paid the debt of the individual partner for whose debt he is surety (1). On the other hand, the surety is entitled to subrogation to such securities as are given for the identical debt. Thus, a man gave a promissory note on which there was a surety. The note was given in payment of land bought by the maker. The creditor retained a lien on the land sold, as security for the amount still due him. The maker sold the land to a person who knew of these circumstances. The maker of the note became bankrupt, and the surety sought to enforce the creditor's lien against the land in the hands of the vendee of the maker of the note, he having paid the note. The court held he was entitled to enforce the lien against the land, for this lien was given the payee of the note as security, and the surety, having paid the note, is entitled to the benefit of this lien (2). As has been previously stated, the right of subrogation exists independently of contract; and therefore the surety may be sub-

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(1) Stafford v. Bank, 132 Massachusetts, 315.
(2) Uzzell v. Mack, 4 Humphrey (Tenn.) 319.

rogated to all securities, whether taken at the time the debt was created or subsequently thereto, and regardless of whether the surety, when he became bound, knew whether such securities had been given to the creditor. The right of subrogation arises as soon as the suretyship relation is created, though the right to enforce it does not arise till the surety pays the debt.

§ 60. **When surety can enforce securities.** When a surety pays a suretyship debt a cause of action for reimbursement at once arises, and at this time his right of subrogation to the securities held by creditors also arises. As was stated above, the right to be subrogated if the surety pays the debt arises as soon as the contract of suretyship is entered into, but he has no enforceable cause of action until he actually does pay the debt. Thus, the plaintiff in a certain suit was surety on a promissory note secured by a chattel mortgage on some goods, and was forced to pay the note. He then brought a bill in equity claiming the right to enforce the chattel mortgage, and the court held he had the right to enforce the creditor's rights, and could enforce the mortgage or take possession of the mortgaged property in the same manner as the creditor could have done, if the note had not been paid (3). We have seen that if the creditor releases a security before the surety pays the debt, he thereby releases the surety to the extent of the value of such security (4). If the creditor releases a security after the surety has paid the debt, such release is not valid as to the

(3) Myers v. Yaple, 6 Michigan, 339.

(4) § 31, above.

surety; and he can, in spite of it, enforce his right of subrogation to this security against all but bona fide purchasers for value and without notice (5). After payment by the surety the creditor has no right to release any security for the debt, but must hold all securities in trust for the benefit of the surety, until the latter is reimbursed for all he has been compelled to pay by reason of the suretyship contract.

§ 61. **When stranger pays debt.** The right of subrogation is given only to sureties or to those who have to pay the debt to protect their own interests. A mere volunteer or stranger cannot pay a debt for which another is bound, and claim the right to stand in the place of the creditor in respect to his rights against the debtor (6). The right can be claimed only by one bound as surety, or by one who is forced to pay the debt in order to protect his own interest. For instance, when a vendee of land pays a mortgage debt of his vendor, in order to prevent foreclosure of the mortgage on his land, he is entitled to subrogation to the mortgagee's rights against his vendor. This really involves the law of suretyship, for, though the vendee who pays the mortgage is not personally liable as surety for his vendor, the land is liable. Therefore, the land stands as surety for the debt, and in order to protect his interest in it the vendee has to pay the mortgage debt.

§ 62. **When surety is not entitled to subrogation.** Subrogation is allowed only under certain circumstances. In the first place, a surety cannot enforce this right until he

(5) Hough v. Insurance Company, 57 Illinois, 318.

(6) Bartholomew v. Bank, 57 Kansas, 594.

has paid the entire debt; because the right will never be allowed where it will result in an injustice to the creditor who is the party who has the right to payment both from principal and surety. His rights against the principal cannot be infringed, so long as any portion of the debt remains unpaid. Thus, a surety on a replevin bond, after he had paid all the damages due on the bond, petitioned for subrogation to the rights of the creditor on the judgment against the principal debtor. The creditor answered that the judgment was not yet fully paid. The court said that subrogation rested on purely equitable grounds and would not be enforced against superior equities. Unless the surety pays the debt in full he is not entitled to subrogation, and, until this is done, the creditor will be left in full possession and control of the debt and the remedies for its enforcement. The right of subrogation will never be allowed to the prejudice and injury of the creditor (7). This being true, then the surety must see that all of the debt is paid, whether he is liable for all of it or not, before he is entitled to subrogation—that is, if the debt is $2,000 and the surety is bound to the extent of $1,000 only, he must pay the entire amount still due the creditor, or any attempt to enforce subrogation would injure the rights of the creditor.

§ 63. When subrogation may be allowed before debt fully paid. Although, as just stated, as a general rule the surety must pay the full debt before subrogation can be had, yet there are cases where it may be allowed before such debt is paid. The chief reason for not allowing it

(7) Musgrave v. Dickson, 172 Pennsylvania, 629.

before payment of the debt being that it would injure the creditor, the right may be allowed when the creditor does not object. The creditor may hold securities for the debt worth much more than the amount due him. Then, when the surety has paid a portion of the debt, he may, with consent of the creditor, reimburse himself out of the creditor's securities. In some respects the surety may rank directly as a creditor of the principal, before he has paid any part of the obligation. The principal's contingent liability to the surety permits the surety to exercise a creditor's right to set aside a fraudulent conveyance, made by the principal (8). Here the object of the suit is to set aside a conveyance so that the principal's creditors can get the property which the principal wrongfully disposed of, and doing this cannot injure the creditor, but would benefit him, since he would have this additional property to proceed against in collecting his debt (see § 65, below).

§ 64. **What amounts to payment of debt.** It is only required that the debt be paid, no matter by whom, before subrogation may be enforced by a surety. Part may be paid by the principal, or part may be contributed by other sureties. A payment by a surety will discharge securities as between the creditor and the principal, but does not have that effect as between the surety and the principal, for equity will keep the securities alive for the benefit of the surety. Thus, in the case of Uzzell v. Mack, cited above (9), the lien in question was a vendor's lien on the

(8) Longbridge v. Bowland, 52 Mississippi, 546.
(9) § 59.

land, and payment of the purchase money by the surety extinguished it; but equity nevertheless held the surety was entitled to subrogation. At law, payment of a bond, note, or judgment extinguished it, but nevertheless the surety can in equity enforce such instruments, after paying the creditor. Equity, in general, will keep the right of the creditor alive where it is necessary for the protection of the surety.

§ 65. Surety a creditor of principal debtor. In equity, a surety is regarded as a creditor of a principal debtor. If the latter becomes insolvent, the former may retain any securities in his possession belonging to the principal. Securities taken by one of two or more sureties inure to the benefit of all, for sureties are entitled not only to the benefit of the creditor's securities but also to the benefit of those held by co-sureties.

That a surety, for some purposes, is regarded as a creditor of the principal is shown by the law as to fraudulent conveyances made by the principal. A surety's liability before he pays the debt, though contingent, is as fully protected against a fraudulent voluntary conveyance as after he has paid the debt; for his claim is considered in equity as having existed from the time he became surety, and a subsequent payment of the debt extends back by relation to that date, though no cause of action accrues till payment is made. So, after he pays the debt, he is to be considered as having been a creditor from the time the debt was created, and as such is protected from fraudulent conveyances (10), and can proceed in his own right

(10) Bragg v. Patterson, 85 Alabama, 283.

to set aside any which have been made after he became bound as surety. As to his right before he has paid the debt, see § 63, above.

§ 66. **Exemptions of principal.** When parties enter into a contract, the laws in force at that time and at that place enter into and become a part of such contract. Thus, parties entering into a contract are presumed to have had in view such exemption laws as were in force at that time. As against a surety, the homestead and other exemption rights of the principal apply as of the date of the contract, and not as of the date of the payment of the debt.

The value of the right of subrogation to the surety is no where better illustrated than in cases involving exemptions. In a Michigan case (11) an administrator of an intestate estate bought a homestead with some of the funds of the estate. The creditors of the estate forced the surety on the administrator's bond to make good the funds misapplied. The surety could not reach the debtor's homestead by an action of law, so he brought a bill in equity asking to be subrogated to the right of the estate to follow the misappropriated trust fund. The court held he was entitled to enforce this right, and could recover out of the homestead the amount of the fund applied to its purchase. The law, then, is that where an exemption law stands in the way of the surety's direct recovery from the principal, if the creditor could have avoided such exemption law, the surety can avoid the exemption by subrogation to the right of the creditor.

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(11) Pierce v. Holzer, 65 Michigan, 263.

§ 67. Payment of specialty debt by surety. When a bond or other specialty is paid, it is at law extinguished, but when paid by a surety the rule in equity is different in most jurisdictions. The general rule is that payment of a specialty by a surety does not, in equity, extinguish it as to such surety; but it is kept alive for his benefit, and he may be subrogated to the creditor's right on it. Thus, in a certain case (12) an indorser paid a bill of exchange and then filed a bill in equity for contribution against the estate of a co-indorser, who had become insolvent, claiming that he should be subrogated to the creditor's right on the bill and that he was then entitled to the rank of a specialty creditor in the division of the assets. The case arose in Virginia, by the law of which state at that time one who held a bill of exchange was entitled to rank with judgment creditors and therefore was entitled to payment from the assets of an insolvent estate prior to ordinary creditors. Other creditors claimed the payment extinguished the bill of exchange and the surety could only rank as an ordinary creditor in the distribution of assets. The court held that, though extinguished at law, the bill of exchange in equity would nevertheless be kept alive for the benefit of the surety, and therefore he would rank with judgment creditors. The creditor would have had this privilege had he not been paid, and the surety has the same right. This represents the weight of authority on this question.

§ 68. Payment of judgment debt. As to a judgment, the general rule is that payment by the surety of a judg-

(12) Lidderdales v. Robinson, 12 Wheaton, 594.

ment rendered against him and the principal or against an insolvent principal alone, will entitle the surety to subrogation to the benefits of such judgment, which he may enforce against the principal. In the case of Hill v. King (13) certain judgments were obtained against a principal and the sureties on a bond. The principal became insolvent, after conveying to the defendant in this suit his land on which the judgments were liens. One of the sureties, the plaintiff in the suit, paid the judgments, and sought to enforce the lien of the judgments against the land conveyed by the principal to the defendant. The defendant claimed that payment of the judgments extinguished them and removed the lien from the land, but the court held that since the plaintiff had paid the judgments he was entitled, in equity, to enforce the lien of such judgments against the land in defendant's possession; for, as between the principal and surety, the judgments were not extinguished. The judgments in this case were paid prior to the conveyance of the land to the defendant, but the rule is the same where the conveyance is subsequent to the judgment but prior to the payment by the surety (14). While the above is the general rule, there are several states which hold that payment of a judgment by a surety extinguishes it completely as between principal and surety and the latter cannot be subrogated to it. But equity and justice would appear to be with the weight of authority on this point.

§ 69. **Extent of subrogation: Against principal.** A

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(13) Hill v. King, 48 Ohio State, 75.

(14) Perrin v. Higgins, 101 Indiana, 178.

surety who pays the principal's debt is entitled to indemnity from the principal, and his right of subrogation, given by equity as an additional right to enable him to indemnify himself, entitles him to only the amount he has actually paid, together with interest from the date of payment, and costs. He is entitled to no more than repayment of the amount he has actually expended. To illustrate: There were two sureties on a note for $16,000. One surety died insolvent, and the other surety paid the note and filed his claim against the insolvent estate for the whole debt, the principal being also insolvent. Being a co-surety he was entitled to contribution for one-half, or $8,000. The other creditors of the deceased surety claimed he could prove his claim and receive dividends only on the basis of an $8,000 debt. It was held, however, that since the creditor could have proved his claim and received dividends on the entire debt, and since the surety who paid the debt was entitled to be subrogated to the creditor's rights, he could prove his claim and receive dividends on the entire $16,000, until the amount of the dividends received by him equalled the amount he was entitled to receive as contribution. Thus he could collect dividends to the extent of $8,000 (15). This case shows that subrogation is often better than indemnity; for, had the surety in this case claimed contribution only he could have proved his claim for only $8,000, the extent of his right of contribution; but, being subrogated to the creditor's right, which was for $16,000, if the estate paid fifty cents on the dollar he would get his $8,000 in full.

(15) Pace v. Pace's Administrator, 95 Virginia, 792.

If the surety pays the debt in depreciated currency, he can recover only the actual value of what he paid at the time of payment. If he settles the debt for less than its face value, he can recover only what he actually settled for. He may pay the debt in his own obligations or by means of a set-off against the creditor, and such payment will be regarded the same as if made in money.

§ 70. **Same: Against other persons.** As has already been indicated, the surety's right of subrogation extends not only to the creditor's right against the principal, but to all the rights of the creditor respecting the debt which the surety pays. A Massachusetts case (16) furnishes a good example of this. A was surety on the probate bond of B, a trustee. B pledged stocks belonging to the trust estate to secure a personal debt due to C. At the request of B, C sold the stock and applied the proceeds to the payment of B's debt to him. The stock showed on its face that it was trust property, so C was not a bona fide purchaser of it. B was removed as trustee and a new trustee appointed, who sued A on the bond and compelled him to pay the value of the stock appropriated by B. A sought to be subrogated to the trust estate's right against C, but C insisted that the stock was not pledged for the debt that A paid, and therefore he had no right against C. The court held that A, having replaced the fund lost, was entitled to subrogation to all the trust estate's rights to recover the fund, and one of these rights was to follow it into the hands of the defendant, C. In other words, the surety

(16) Blake v. Traders' National Bank, 145 Massachusetts, 13.

who pays the debt may proceed against anyone who is primarily liable for it.

§ 71. **Debt barred against principal.** The right of action in favor of the surety arises when he pays the debt, and is not based on the contract itself but upon a contract implied by law between the principal and the surety. If this right against the principal is barred as between the principal and the surety by the statute of limitations, and the creditor has any right which would not have been barred as between the creditor and the principal had the debt not been paid, the surety may be subrogated to such right of the creditor. This is of advantage to the surety, because his right of indemnity, being on an implied contract, is often barred in a comparatively short time, usually five or six years, while the creditor may have rights which are not barred until after fifteen or twenty years. Thus, a plaintiff was surety on a promissory note and paid it when due. In Iowa, when the action was brought, an action on implied contract was barred after five years, but an action on a promissory note was not barred until ten years had elapsed. The plaintiff sought subrogation to the creditor's right on the note more than five years after paying the debt, but before the statute had run on the note. It was held he had a right to enforce the note as long as the creditor could have enforced it (17). The right of subrogation, then, exists until the creditor's right would have been barred, and no longer.

§ 72. **Surety of a surety.** As stated above (18), a surety who pays the debt has the right of subrogation to

(17) Harrah v. Jacobs, 75 Iowa, 72.
(18) §§ 69-70.

the creditor's right against anyone primarily liable for the debt. The same right is given to one who becomes the surety of a surety, and pays the debt. When a party becomes a surety for the original surety, the former is not bound with the original surety, but the latter stands in relation of principal as to him and is primarily liable to him. Hence, if the second surety pays the debt, he is entitled to subrogation to the creditor's rights against both the principal and his immediate surety. But, if the first surety pays the debt, since his relation is that of principal to the second surety, he cannot recover from such second surety, for the latter is not primarily liable for the debt. As to him, payment of the debt by the original surety is only a payment by his principal, and exonerates him from further liability.

§ 73. **Two sets of sureties.** There may be two sets of sureties of the same principal for the same debt, one subsequent to the other. In such case the subsequent set of sureties are primarily liable for the debt to the first set of sureties, and the latter are secondarily liable. For instance, a party who lost a suit at law wished to appeal, and gave a bond for $7,000 with two sureties on it. He lost the appeal and appealed from this decision to a higher court, giving a $9,000 bond with two new sureties, and again lost his appeal. The creditor's damages amounted to $11,000 and he recovered $9,000, the full amount of the bond, from the sureties on the second bond, and then sued the sureties on the first bond for the remaining $2,000 still due him. In such a case the sureties on the second bond are primarily liable; and, if the sureties on the first

bond had paid $7,000, they would have been subrogated to so much of the creditor's rights on the second bond as remained after the creditor was fully satisfied. Here the creditor could have gotten $4,000 on the second bond after getting $7,000 on the first bond; and the sureties on the latter could then have enforced the second bond to the extent of $5,000. But, since the creditor collected the entire amount on the second bond, the sureties on the first bond, being secondarily liable, were bound to make good any amount which might still be due, here $2,000; inasmuch as the sureties on the second bond were liable not for the whole amount due the creditor, but for only $9,000. It was therefore held, in a case similar to this, that the creditor could recover $2,000 on the first bond (19). The fact that there was a bond given with new sureties did not release the original sureties. When two sets of sureties enter into obligation as to the same debt at the same time, they are liable as co-sureties.

§ 74. **Co-Sureties.** A surety who pays the principal's debt is entitled to subrogation to the creditor's rights against his co-sureties, and can recover in this way from such co-sureties the amount of contribution to which he is entitled. The principle of subrogation applies to cases arising between co-sureties, as well as to those arising between principal and surety. The case discussed in § 69, above, is a case where this right of subrogation was enforced against a co-surety. There the surety had paid a debt of $16,000, was allowed subrogation to the creditor's right, and was thus able to file his claim for $16,000

(19) Chester v. Broderick, 131 New York, 549.

against the estate of the insolvent co-surety and collect dividends on that amount, until the total dividends amounted to $8,000, the amount of contribution he was entitled to. A surety will be entitled to the benefit of any compromise effected by the paying surety, or any discounts which have been obtained by paying the debt in depreciated currency, or any other reduction. A proportionate amount of such benefits must be deducted from the amount of contribution he pays. On the other hand, he must contribute for costs of a suit beneficial to his interest.

Section 2. Indemnity.

§ 75. **Liability of principal to surety.** The right of the surety to indemnity from the principal, for any payment which he may make to the creditor in consequence of the suretyship liability, arises at the time the surety becomes responsible for the debt of the principal. It is then the law raises an implied promise or contract on the part of the principal to make good any loss which the surety may suffer. When the debt is paid by the surety, no new contract is made, but the payment relates back to the time when the contract was entered into by which the surety's liability was incurred. Thus, the court in Appleton v. Bascom (20) in considering whether an action at law could be maintained by the surety against the principal said: "The implied promise of indemnity in the present case must be considered as made at the time when the plaintiff became responsible to the creditor on the bond.

(20) 3 Metcalf, 169.

The plaintiff's liability was the consideration of the principal's implied promise of indemnity, and the promise must be considered as made at the time when that liability was assumed." The payment by the surety only fixes the amount of damages for which the principal is liable under his original agreement to indemnify the surety. If a surety, however, gives his own bond or non-negotiable note in satisfaction of the principal's obligation, he cannot, before payment of such bond or note, secure indemnity from the principal; the giving of such an instrument is not considered a payment of the debt, for, should the surety fail to pay the note or bond, the creditor could still sue the principal on the original obligation (21). The rule would be different, however, if there was an agreement between the creditor and surety that the former was to take the surety's note in full payment of the debt due him, for such agreement would extinguish the debt of the principal to the creditor and would in fact amount to a payment.

§ 76. **Payment by surety before maturity.** The surety may pay the debt before it is due, if the principal is not injured thereby; but of course he cannot, if he does so, enforce indemnity against the principal until the debt matures. Likewise, a surety has a right to pay the debt as soon as due, and need not wait for the creditor to sue him. In fact, as we saw above (22), the surety cannot require the creditor to sue the principal, because the burden is on the surety to see the debt is paid. On payment of the debt before maturity, the surety can compel contribution

(21) Bennett v. Buchanan, 3 Indiana, 47.

(22) § 36.

from co-sureties as soon as the debt comes due, for a payment before it is due is not a thing of which they can complain. It does not increase their burdens.

§ 77. **Part payment by surety.** The surety may compromise the debt or pay any part of it remaining due, and compel the principal to indemnify him. He may pay in instalments if he wishes, but if he does so he cannot bring a separate action against the principal for each instalment paid, unless the contract so provides. In short, any method of payment may be adopted by the surety, and he is entitled to indemnity for his outlay, whatever it may amount to, regardless of whether he has paid all the debt or not. Clearly, the payment of any amount, however small, releases the principal from so much liability to the creditor. Of course, if he compromises the debt and pays less than due in full satisfaction, he can recover only what he actually paid for he is only entitled to be made whole.

§ 78. **Surety must be under legal obligation to pay.** In order to secure the right of indemnity from the principal, the surety must be under legal obligation to pay—he must be legally bound in order to hold his principal. The theory of indemnity is that, when the debt comes due, the law implies a promise on the part of the principal to repay the surety, if the latter pays it; and, if the surety is not bound to pay, then there can be no such implied promise. He would pay as a mere volunteer and could not recover anything from the principal. The rule is the same when the surety is released from liability and then pays the debt; for, because he is released and

no longer a surety, he cannot have any of the rights growing out of such relation. In short, a surety not legally bound to pay, if he does pay, occupies no better position than any other person paying the debt of another without request or authority, express or implied.

§ 79. **Surety to one of two or more partners.** A surety can look only to his principal for indemnity, so a surety on the bond of one partner cannot look to the partnership for indemnity, even though the bond be given to secure a partnership debt. No privity exists between the parties, except that which arises out of the bond. Privity between the parties must be shown by the contract, and there is no privity shown on the bond except as to the one partner who signs it. But it was held, where a note was given by one partner for the hire of a man for the benefit of the firm with the knowledge and consent of both partners, and the entire consideration of the note went to the benefit of the firm and was so intended by the partners, that, since the benefit enured to the firm, a surety on the note might maintain an action against the partners jointly for money he had been forced to pay on the note (23). Perhaps this might be on the quasi-contractual ground that the firm got the benefit, and therefore ought to pay for it whatever sum such benefit increased the value of the firm assets.

§ 80. **Note of surety given in payment.** The law is that if the surety gives his bond or non-negotiable note in satisfaction of the debt, he cannot recover indemnity until such bond or note is actually paid, because such note or

(23) Burns v. Parish, 3 B. Monroe (Ky.) 8.

bond is not the same as money. But when he gives his negotiable note in payment of the debt after it is due, if the creditor receives such note as payment, he may recover reimbursement, for the debt is absolutely satisfied by the transaction. In some states, however, a negotiable note must be actually paid by the surety before any right of action for indemnity arises against the principal. In any case when the surety gives his note in payment, it must be taken by the creditor in satisfaction of the debt against the principal; that is, the debt against the principal must be extinguished, or no indemnity can be had. When the debt is extinguished, the principal is as much benefited as if payment had been made in money.

§ 81. **Debt satisfied from surety's property.** If the surety pays the principal's debt by giving property for it, or if his property is taken by legal process, he can at once sue the principal for indemnity. Thus, where a surety's land was levied on and sold to satisfy the suretyship debt, and the surety then brought an action against the principal for indemnity, it was held he could recover (24). The surety can also, when his property is taken for the debt, recover contribution from a co-surety.

§ 82. **Recovery of consequential damages.** When a surety can show that, by reason of the non-payment of the debt by the principal, he has suffered damages in excess of the principal and interest he has been compelled to pay, he may recover such excess damage from the principal (25). But he is seldom able to show this, and, as a general rule, he cannot recover from the prin-

(24) Lord v. Staples, 23 New Hampshire, 448.
(25) Whereatt v. Ellis, 103 Wisconsin, 348.

cipal remote or consequential damages arising out of the suretyship contract. He is not entitled to remuneration for loss sustained by a forced or hasty sale of his property in order to raise money to pay the debt, but can recover only principal and interest actually paid. The same is true when his goods are sold on execution or attachment by the creditor. Losses from such causes may be quite heavy, yet the surety has no relief except that he may bring a bill of equity, before any such damage occurs, and compel the principal to exonerate him. This right of exoneration will be discussed later (26).

§ 83. **When surety's right of action is complete.** It is well settled law that no action can be maintained by the surety upon an implied promise, if default has been made by the principal, without first paying the debt; except where the principal has made an express promise to do or refrain from doing some particular act or to save the surety from some particular charge or liability, and has broken such promise. For instance, suppose a principal, who makes a note, agrees with the surety on the note that he will pay the note on a given day. Then, if the principal does not pay it on that date as he promised, the surety can sue him and recover without first paying the note himself. Likewise, if a partner retires from the partnership and the new firm agrees with him to pay all the debts of the old firm and save him harmless from any liability on account of the same, upon default of the new firm he can recover at once without paying the debt (27).

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(26) §§ 100-104, below.

(27) Lathrop v. Atwood, 21 Connecticut, 117.

If, however, there be no affirmative promise to do a certain act or to pay certain money, then actual damages must be shown by the surety or the debt paid by him, before any action can be maintained by him against the principal.

§ 84. **Principal liable for surety's costs and interest.** A surety can recover money paid by him for the principal, with interest, and is also entitled to recover such reasonable costs as he has been compelled to pay in his action to recover from the principal. He can also recover costs he has had to pay in defending a suit by the creditor against him. But the principal is not liable for costs and expenses, unnecessarily incurred by the surety in litigation carried on, in order to defeat the efforts of the creditor seeking to recover from him. It is therefore required that the surety seeking to recover costs of litigation with the creditor show that such litigation was entered into in good faith and upon reasonable grounds, and was a measure of defense necessary to the interests of himself and his principal (28). A surety has a right to defend a suit on the debt brought by the creditor against the principal, when the principal does not defend with due diligence, and costs of such suit may be recovered from the principal.

§ 85. **Amount surety can collect.** The surety can collect from the principal only the amount he has paid, with interest and costs. This is because the implied contract between the principal and surety is that, if the surety will enter into the suretyship contract, the principal will re-

(28) Ledfield v. Haight, 27 Connecticut, 31.

pay the surety anything he may be compelled to pay by reason of such contract. In other words, the implied contract is a contract of indemnity only, and therefore, if the surety satisfies the debt by compromise or otherwise for less than its face value, he can recover only what he actually paid for such satisfaction. An accommodation endorsee of a negotiable note, however, if he purchases the instrument he indorsed, can recover the full face value. This is because an endorsee has as much right as anyone else to purchase negotiable paper, and can enforce it in the same way as others, without regard to what he paid for it.

§ 86. **When principal is not liable.** In general, in order to make the principal reimburse the surety, the principal must be liable for the debt, though the surety may be liable and may have to pay when the principal is not liable. The surety's recovery can arise only from payment of money he was legally bound to pay. If the surety knows of facts which will discharge him or his principal and yet pays the creditor, he cannot recover indemnity from the principal. But where he pays without fraud or negligence on his part, though there is a good defense to the obligation of which he does not know, he can recover from the principal; for the latter should see that the surety knows of any defense there may be. The surety is not bound to allow himself to be sued before he pays the debt, but may pay it as soon as due when he knows of no defense to it. When the surety pays a debt which, as between the principal and creditor, is barred by a statute of limitations, he can nevertheless recover in-

demnity from the principal. For instance, a surety paid a note after the principal was dead, and after the time allowed by statute for filing claims against his estate had elapsed, so that the creditor could not recover from the principal's estate. The surety sued the principal's estate for indemnity, and the principal's administrator claimed the debt was barred by the statute of limitations. But the court held, though the creditor's right of action was barred as to the estate, that the surety still remained liable to the creditor and had to pay the debt, and therefore was entitled to recover whatever he paid to discharge himself from such liability (29). According to this case the surety, so long as he remains liable, may pay the debt and recover indemnity, regardless as to whether or not the claim is barred as to the principal. After the creditor's right against the surety is barred, the surety ought not to ignore this defense, pay the claim, and then recover from the principal; although there is considerable authority that he may do this where the creditor's claim against the principal is not barred. This latter view may perhaps be justified as amounting to a purchase by the surety of an assignment of the claim.

§ 87. **Waiver of statute of limitations by principal.** A partial payment of a claim barred by the statute of limitations waives the bar of the statute, so that a creditor can enforce the debt again and the statute starts to run anew from the time such a partial payment was made. If a principal is a co-obligor with a surety, that is, if both are primarily liable to the creditor, and the principal

(29) Sibley v. McAllaster, 8 New Hampshire, 389.

makes a part payment of the debt after it is barred by the statute of limitations, this will not revive the claim against the surety (30). The same is true when the surety is secondarily liable as to the principal. The waiver of the statute of limitations by the principal does not waive it as to the surety.

§ 88. **Payment of judgment by surety.** A surety who pays a judgment rendered against him individually, or jointly against him and the principal, even though he does not defend the suit against him with diligence (31), or even though he allows the judgment to go against him by default, he not knowing of any defense to the action, can recover the amount he paid from the principal. As stated before, if he knows of a defense he must not ignore it. It is the duty of the principal, if he has a defense, to set it up at the trial, whether the action is against him, against the surety separately, or jointly against both; and, if he does not do so, he cannot set up such defense in a suit by the surety against him for indemnity. Suppose the principal gave a promissory note for $500, and at the time the note became due has a claim against the creditor for $500 which he can set off against the note. The creditor sues the surety on the note, and he, having no defense, lets the judgment go against him by default, pays it, and then sues the principal. The latter would have to pay the surety in full, and then, if he wished relief, would be obliged to sue the creditor to recover the amount of the set-off.

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(30) Bordell v. Peay, 20 Arkansas, 293.
(31) Doran v. Davis, 43 Iowa, 86.

Section 3. Contribution.

§ 89. **Right to contribution.** If one co-surety pays the debt after the principal has defaulted, he has a right to contribution from the other co-sureties. This right of contribution, like indemnity and subrogation, is not founded upon any contract between the co-sureties, for there is none; but is founded on the principle of equity arising from the proposition that, when two or more sureties stand in the same relation to the principal, they are entitled equally to all the benefits and must bear equally all the burdens of the position. Hence, it does not matter that the several sureties were ignorant of each other's liability; they are entitled to contribution if they stand in the same position in respect to the principal, unless some have equities which give them an advantage over others. Contribution was at first enforced only in courts of equity, but the right has been so long and so generally recognized and enforced that law courts now enforce it as well as equity courts.

§ 90. **When the right arises.** The right of contribution arises when one co-surety pays more than his proportionate share of the debt upon which the principal has defaulted. He then is entitled to recover all in excess of his proportionate share from the other co-sureties. The surety must be legally bound when he pays, or he cannot have contribution. In general he can have contribution in cases where he can enforce indemnity against the principal.

§ 91. **Enforcement in equity: Against whom and amount of recovery.** In a suit in equity the surety is en-

titled to contribution, and can recover from each solvent co-surety his pro rata amount, excluding all insolvent co-sureties. Thus, where A, B, and C are co-sureties for a debt of $600, and A pays the entire debt and brings a bill in equity for contribution, if all three sureties are solvent he can recover $200 from each co-surety. If, on the other hand, C is insolvent, B would be forced to contribute one-half of the debt, or $300, the burden resting equally upon the two solvent sureties (32). If a surety is a non-resident, the effect is the same as when insolvent, and the debt is divided equally among the resident solvent sureties (33). Thus, in the above example, had C been a non-resident, B would have been liable for one-half the entire amount. After enforcing contribution from the resident solvent sureties, all of the sureties who have paid shares of the debt may proceed against the estate of any insolvent surety, or may follow a non-resident surety and sue him wherever he can be found, but no one surety can recover more than the excess he has paid, over and above the amount he would have had to pay had all co-sureties been forced to contribute. So, in the above case, B could proceed against C's estate if C was insolvent, but could recover only $100; for, had all three sureties contributed, each would have paid $200, and therefore the excess B paid was $100.

§ 92. **Same: Conditions precedent and parties.** In equity, before a surety who has paid the debt can enforce contribution from co-sureties, he must recover, if possible, from the principal; and must show in his bill for

(32) Peter v. Rich, 1 Reports in Chancery, 34

(33) Stewart v. Goulden, 52 Michigan, 143.

contribution that the principal is insolvent, or must show some other sufficient reason why he cannot recover from such principal. The reason for this rule in equity is that it prevents a multiplicity of suits and avoids circuity of action. Suppose, for instance, A, B, and C are sureties for D, and A pays the debt. If A recovers contribution from B and C, then all three sureties must sue D for indemnity; but, if A is first forced to sue D for indemnity, if D is solvent the entire affair will be settled in one suit, whereas otherwise four would be required. The surety therefore is required by a court of equity to recover from the principal, if he can, before enforcing contribution against his co-sureties (34).

In a suit in equity to enforce contribution, the surety must join the principal as a party defendant if he is within the jurisdiction, or else prove that he is insolvent; and must also join all solvent sureties within the jurisdiction. Then, if the principal be joined and has property available, full recovery can be had from him; and, if nothing can be thus obtained, contribution may be had from the solvent sureties in the same action.

§ 93. **Enforcement at law.** At law, the right of contribution has come in theory to be based on implied contract. By the weight of authority, it is held that there is an implied promise by each surety to pay an aliquot part of the debt, in case of the principal's default. The default, then, under this theory, renders the surety liable to pay such aliquot part, regardless of whether the principal is solvent or not. This share of the debt is also

(34) Gross v. Davis, 87 Tennessee, 226.

all that he is liable for at law, regardless of whether or not the other sureties are able to pay. A surety who pays the debt can sue at law for contribution as soon as there is default by the principal, but he must sue each surety separately for his proportion of the debt, based on the number of co-sureties, without regard to their solvency. Thus, in an English case (35) it was found that there were twelve sureties for a debt, of which the defendant was one. Two of the twelve were insolvent. The defendant admitted he was liable to contribute one-twelfth the amount of the debt, all of which had been paid by the plaintiff, and paid one-twelfth into court. The plaintiff claimed he should pay one-tenth, as there remained only ten solvent sureties, but the court held that, in an action at law for contribution, a surety was liable for only his proportionate share, based on the total number of sureties, and hence one-twelfth was all the defendant was liable for. Had the suit been brought in equity, the defendant could have been forced to pay one-tenth. The surety who pays the debt is of course entitled to contribution for necessary costs of suit and other necessary expenses. In some states the equitable rule as to contribution is applied by the law courts, and the amount of contribution is based on the number of solvent sureties (36).

§ 94. **Rights of surety to benefits obtained by co-surety: Advantageous settlement.** Co-sureties are entitled to the benefit of all bargains and advantages secured by one

(35) Batard v. Hawes, 2 Ellis & Blackburn, 287.
(36) Smith v. Mason, 44 Nebraska, 610.

of their number in settling the claim. A surety is not entitled to derive benefits from the suretyship relation which are not shared by his co-sureties. If he pays less than the whole debt in full settlement he can recover only the pro rata share of what he paid from the co-sureties. If he pays in property, he can recover only on the basis of the actual value of such property. Thus, one of the sureties on an obligation for $1200 bought it from the creditor for $900, and then sued the two co-sureties for contribution, claiming he was entitled to recover $400 from each of them. The court, however, held that the plaintiff's co-sureties were entitled to share in the benefits of his bargain, and that he could recover from each only one-third of the amount he paid, or $300 (37).

§ 95. **Same: Securities.** Indemnity paid to one surety enures to the benefit of his co-sureties. If the surety has securities given him for the debt and releases them, he loses his right of contribution against co-sureties, just as the release of securities by the creditor releases the sureties (§ 31, above); for the co-sureties have a right of subrogation to the benefit of any security held by any one of their number, and a release of it injures this right. As the New Jersey court said (38):

"It is not questioned but that co-sureties are entitled, not only to contribution from each other towards the moneys paid in discharge of this joint liability, but also to the benefits of all the securities which any of them may have taken to indemnify himself. Nor is it disputed that when

(37) Acers v. Curtis, 68 Texas, 423.
(38) Paulin v. Kaighn, 29 New Jersey, 480.

one surety holds securities for his indemnity, the mere fact of his holding such securities will not bar a recovery in an action for contribution. After such recovery and payment of the judgment, the defendant may, in a proper tribunal, enforce his right of subrogation to such securities and so secure the benefit of them. If, however, the surety, before the action for contribution, shall have converted the securities for indemnity into money, that will go pro tanto in liquidation of the amount paid on the liability; and it is competent for the co-surety, in an action against him, to show that money has been so realized. It is a payment of so much by the original debtor, and so far an extinguishment of the liability. All of the sureties have an equal interest in the indemnity, and in the money realized from it. The surety who held it has no right to appropriate to his own use the whole money so realized, nor has he a right to deprive his co-sureties, without their consent, of the benefits to be derived from it. He becomes their trustee, and as such must faithfully hold the securities for the benefit of all his co-sureties, and he has no right, without their consent, to transfer surrender, or cancel them."

In this case, the surety suing for contribution had surrendered securities given him to the principal, without consent of co-sureties, and it was held this released such co-sureties to the extent to which such surrender might have injured them. Similarly, if a surety wastes the collateral security in his hands or negligently suffers it to be lost or impaired in value, he must account to his co-sureties for such loss or depreciation.

§ 96. **Co-Sureties under different undertakings.** It is well settled law that parties may become co-sureties under different suretyship contracts, executed at different times, even though those bound by one contract have no knowledge that another contract, on which there were other sureties, was made. But the obligations into which they enter must be for the same engagement and for the same principal. It is enough to sustain the right of contribution, if it appears that the parties are under obligation to pay the same debt as sureties for the same person. A striking instance of the application of the right of contribution, as between sureties for the same obligation who became sureties at different times, is furnished by a Massachusetts case. The plaintiff had sent negotiable notes to a corporation, which was to sell them on commission and remit the proceeds, and the defendants had also sent some notes to the same corporation for the same purpose but at a different time. The corporation wrongfully pledged the notes of both the plaintiff and defendant to secure a debt it owed the pledgee; and the pledgee, being a bona fide holder of the notes, collected enough of the notes of the plaintiff to satisfy the debt due him from the corporation, the pledgor. The corporation was insolvent and the plaintiffs sought contribution in equity from the defendants, whose notes were pledged for the same debt as the plaintiff's. The court said that the liability to contribute did not depend on a contract between the parties, and was not affected by the fact that the notes were pledged and fell due and were paid at different times, or that some were paid only in part, or not

at all. The notes were all pledged to secure the same indebtedness. The various parties selected a common agent, and this agent used its power to place them all under a common liability, thus virtually making them all sureties for itself. All the notes being pledged for the same indebtedness, the whole loss in consequence thereof was to be borne by all the makers in proportion to the amount of the notes so pledged, and to that extent the plaintiffs were entitled to contribution from the defendants (39).

§ 97. **Same: Liability limited to different amounts.** Sureties may by contract limit their liability to a certain amount. When all are liable to the same extent they must bear the loss equally, but the rule is different in the case of sureties for the same debt of the same principal, if such sureties have their obligations limited to different amounts. In such case they are liable to contribution in proportion to the limitations of their respective liability, and not in equal amounts. This is well illustrated by the following case: A party was appointed guardian of a minor's estate, and there were three sureties on his guardian's bond which was for $10,000. Several years later the court required a further bond of the guardian, and a new bond for $5,000 was given on which there were three new sureties. The guardian misappropriated some funds of the estate and at the time of the suit was insolvent. One of the sureties on the first bond was forced to make good the amount misappropriated by the guardian. This amounted to the sum of $5,-

(39) McBride v. Potter-Lovell Co., 169 Massachusetts, 7.

000. This surety then brought a bill in equity against the other five sureties to enforce contribution. The court held that contribution between co-sureties, under separate instruments, is to be in proportion to the amounts of the separate instruments under which they are respectively bound. Here, then, the sureties on the first bond must bear two-thirds the loss and the sureties on the second bond one-third. Hence, the plaintiff is entitled to recover one-third of two-thirds or two-ninths of the loss from each of the sureties on the first bond, and one-third of one-third or one-ninth of the loss from each surety on the second bond (40). Had the bonds in this case been for the same amount, the two sets of sureties would have been liable to contribute equally toward any loss which might have occurred.

§ 98. **Statute of limitations.** The statute of limitations begins to run on the surety's right of contribution whenever he has paid more than his share of the debt. It is immaterial that, at the time of the action for contribution, the claim of the creditor against the co-surety is barred by the statute of limitations; for the implied obligation is to contribute in case the debt is paid by a co-surety, and the action arises when such co-surety has to pay (41). Of course, if the surety who pays does so knowing there is a defense to an action against him, he loses his right of contribution.

§ 99. **Surety of a surety.** A surety of a surety is not liable for contribution when the debt is paid by the co-

(40) Bell's Administration v. Jasper, 2 Iredell, Equity (N. C.) 597.
(41) May v. Vann, 15 Florida, 553.

surety of the one for whom he is surety. Suppose A and B are co-sureties on a promissory note for $100, and C becomes surety for A's obligation on the note. B pays the entire note and seeks contribution. B cannot enforce contribution as to C, who is a mere surety for A (42). C promised to pay the creditor if A did not, but is under no obligation to contribute to B.

Section 4. Exoneration.

§ 100. **Theory of exoneration.** Exoneration is the right in equity which a surety has, after the suretyship debt falls due, to compel the principal debtor to satisfy the debt and thus relieve the surety from liability. The right may also be enforced against a co-surety as to the amount he is liable to contribute. It is not necessary that the surety who seeks exoneration first pay the debt. It is a remedy given the surety to enable him to relieve himself from payment of the debt. The theory on which the right is based is that the surety, as soon as the debt is due, is liable to be sued and forced to pay. He may have to sell property at a forced sale and may not be able to get full value for it, or his property may be seized and sold on execution; and, since he can recover from the principal only what he actually paid, he may lose a great deal by reason of being compelled to raise money quickly, or by reason of a sale on execution. If he suffers such a loss, it is a loss for which he can get no legal restitution. Therefore, after the debt falls due, a court of equity will allow him to file a bill to compel the party primarily liable

(42) Baldwin v. Fleming, 90 Indiana, 177.

to pay the debt and thus save this possibility of loss; or, he may compel co-sureties to bear their respective shares of the burden (43).

§ 101. **When surety can enforce exoneration.** The right to compel exoneration does not arise until the debt matures. As soon as the debt matures, however, the general rule of law is that the surety may at once file a bill against the principal debtor to compel him to exonerate the surety by paying the creditor. Thus, in a Wisconsin case (44) where the creditor had obtained a judgment against the surety, the latter filed his bill against the principal to compel him to pay the judgment and save the surety from a possible levy. The court said that, since the principal was ultimately liable for the debt, the surety could, in equity, ccmpel his principal to exonerate him from liability by extinguishing the obligation, without first having paid it himself; therefore, the principal would have to pay the judgment against the surety. It is not necessary that the surety first allow a judgment to be secured against him as in this case, but he can proceed to enforce this right as soon as the debt falls due and the principal does not pay it. When there is a co-surety, the same right exists against him to the extent to which he is liable for contribution; for, if the principal be insolvent, the co-surety ought to pay his share, and his failure to do so, according to the theory of exoneration as stated above, may cause the other surety great loss for which he will have no remedy at law or in equity. There

(43) Wolmershausen v. Gullick, [1893] 2 Ch. 514; Hodgson v. Baldwin, 65 Ill. 532.

(44) Dobe v. Fidelity and Casualty Co., 95 Wisconsin, 540.

is an old English case (45) where the principal covenanted to save the surety harmless, and, on the debt falling due, the surety sought by bill in equity to force the principal to pay the creditor and thus exonerate the surety. The court held that it would decree that the principal discharge the debt, for it was unreasonable that the surety always have a cloud hang over him. The principal ought in reason to be compelled to pay the debt and relieve him from this liability.

§ 102. **Express contract by principal to exonerate surety.** When the principal expressly agrees to hold the surety harmless by reason of his suretyship undertaking, if the debt falls due and the principal does not pay it, the surety can in equity specifically enforce this agreement against his principal. If one assumes to pay the debt of another and fails to do so, he will be liable for the full amount regardless of whether the former has paid or not. Thus, if one buys mortgaged land, assuming the mortgage debt, and does not pay it when due, he is liable to the grantor for the entire sum though the grantor has not paid the creditor (46).

§ 103. **Securities given by both principal and surety.** When both principal and surety give securities for the payment of the debt to the creditor, the surety is entitled to have the security given by the principal first applied to payment of the debt, at least where both securities are to be sold or foreclosed in the same proceeding. This, it is clear, is only a matter of right, for the principal is the one who ought to pay the debt and re-

(45) Ranelaugh v. Hayes, 1 Vernon, 189.
(46) Foster v. Stolher, 42 Connecticut, 244.

lieve the surety from liability. Thus, in a certain case (47) a husband and wife had both mortgaged land to secure a debt, for which the husband was principal and the wife surety. The court held the surety was entitled to have the principal's mortgage first applied to payment of the debt. The surety may purchase at a sale of the principal's property which secured the debt, but a principal is not allowed to purchase at a sale by the creditor of the surety's property to satisfy the debt.

§ 104. **Guaranty of collectibility.** If the surety guarantees the collectibility of a note or other debt, the creditor can recover from him if the debt cannot be collected. The creditor must show, before he can recover, however, that the obligation is uncollectible. In such a guaranty, the creditor must use due diligence in trying to collect the debt as soon as it is due, for lack of diligence releases the guarantor. He does not guarantee it will always be collectible. When the party liable has removed from the state, however, the creditor is not compelled to follow him and try to collect before suing the guarantor. If the creditor's lack of diligence in pursuing the parties primarily liable for the debt is induced by the conduct of the guarantor, the latter will not be released from liability.

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(47) Hoppes v. Hoppes, 123 Indiana, 397.

CHAPTER IV.

SPECIAL REMEDY OF CREDITOR.

§ 105. **Creditor's right to surety's securities: From principal.** The creditor has a right to enforce and have the benefit of all bonds and collateral securities which are given by the principal to the surety to indemnify him for his suretyship obligation (1). This is on the theory of subrogation, which right is allowed to the creditor as to securities held by the surety, as well as to the surety as to securities held by the creditor or by a co-surety. In equity, these securities given by the principal are securities for the payment of the debt, and all other parties who are liable for the debt of such principal may have the benefit of such securities. When the surety so holds a security of the principal and the latter is insolvent, the creditor is entitled to enforce such security as against other creditors of the principal, and thus perhaps recover his claim in full; though, had he enforced it directly, he would have had to share with the others of the principal.

§ 106. **Same: From co-sureties.** However, where co-sureties exchange securities with each other, for the purpose of securing the prompt carrying out of their respective suretyship contracts the creditor is not entitled to be subrogated to these securities, since they are not given

(1) Chamberlain v. St. Paul Co., 92 United States, 299.

by the principal. Thus, in a certain case, two parties who became sureties for a certain debt agreed with each other what amount each should be liable to pay, and interchanged mortgages to secure this agreement. The principal and sureties became insolvent, and the creditor claimed the benefit of these mortgages and that he had a right to enforce them against other creditors of the sureties. The court held, however, there were two reasons why the creditor could not enforce these mortgages. In the first place, they were not securities which ever belonged to the principal or were given by him to secure the debt, and hence, they did not come within the rule as contended by the creditors. In the second place, the right of subrogation was a mere right to be substituted in the place of the holder of the security. This would entitle the creditor to enforce the mortgages according to their terms, and the conditions of these mortgages had not been broken (2).

(2) Hampton v. Phipps, 108 United States, 260.

INSURANCE

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CHAPTER I.

GENERAL CONCEPTIONS.

SECTION 1. ORIGIN, NATURE, AND DEFINITION.

§ 1. **Origin of insurance.** The beginning of the law of insurance is more or less doubtful. There are certain indications of it among the earlier Latin races, but the first definite mention of it is in the laws of Rhodes. The law of *marine insurance* appears in fairly definite form in Venice in the twelfth century. From there it worked north into the German states and from there into England. The first English case which involves the law of insurance at all is a case of marine insurance (1). From England it spread to this country in the eighteenth cen-

(1) Crane v. Bell, 4 Coke's Inst. 139.

tury, and it has since steadily grown, both here and in England, until it is today one of the three most important branches of insurance law. *Fire insurance* first made its appearance in England after the great fire of London in 1666. The first important fire insurance company was the Sun Fire Office, which was established in England in 1710, and is still engaged in the insurance business. The first fire insurance company in this country was established in Philadelphia in 1752. The third great division of insurance law is *life insurance.* While there are some early traces of it, life insurance, in the form in which we know it, first made its appearance in England about the middle of the eighteenth century, the Equitable Assurance Company being established in England in 1762. In the United States, comparatively little was done in life insurance until about the middle of the nineteenth century. After the Civil war it grew with great rapidity, and is now one of the most important branches of insurance.

There are many other kinds of insurance, but their principles are the same as in the three main divisions already mentioned. Others are accident insurance, working men's insurance against accidents in their business, guaranty insurance of the fidelity of employees, plate glass insurance, burglar insurance, cyclone and hail insurance, and many other common kinds.

§ 2. **Nature of insurance.** Insurance is essentially a contract or agreement, whereby one party, in consideration of a price paid by another party, guarantees to that other that he shall not suffer loss or damage by the hap-

pening of certain specified contingencies. In fire and marine insurance the principle is entirely that of indemnity. In no circumstances may the insured recover more, and he may recover less, than what he has actually lost. Since the value of a life cannot ordinarily be exactly ascertained, the doctrine of indemnity is not applied to life insurance.

§ 3. **Kinds of policies.** There are several kinds of policies. The most common form of fire policy is the *open policy.* In this the sum mentioned on the face of the policy merely fixes the maximum amount, beyond which the company is under no circumstances liable and in the event of a loss it is open to the company to show that the damage was in fact less than the amount stated in the policy. In the *valued policy,* on the other hand, the value of the property insured is conclusively agreed to by the parties and in the event of loss no question can be raised as to its value; the only question is: Did the loss occur? Marine policies are generally, and life and accident policies practically always, valued. The mere fact that the total sum mentioned in the policy is apportioned among several items does not render the policy valued. Thus, where the policy was for $8500 on one brick and two wooden houses, and opposite the first item was placed the sum of $6700 and opposite the latter item the sum of $1800, the policy was held not to be valued but merely to show the maximum amount of recovery which could be had with respect to each item (2). A *floating policy* is one issued to cover goods in a definite place, but where the goods are constantly changing so

(2) Wallace v. Insurance Company, 4 La. 289.

that the exact articles insured cannot be definitely described. This is frequently used in case of articles in warehouses and stores. This form of policy is also called a *blanket policy*.

A *regular life policy* is where the insurer, in consideration of certain premiums, agrees to pay a stated sum at the death of the person insured to whomever is designated in the policy. An *endowment policy* is where the premiums are paid for a certain number of years, generally ten or twenty. If the insured dies during that time, the face of the policy is paid to the designated person. If the insured lives to the end of the specified period, the face of the policy is paid to him.

§ 4. **Meaning of terms used.** Some of the more commonly used phrases in insurance law are the following: The person or corporation promising the indemnity is the *insurer*. The person taking out the policy and with whom the contract is made is properly designated as the *insured* (3), although the term is sometimes applied to the person to whom the policy is made payable, who of course may or may not be identical with the person taking out the policy. The person to whom the insurance is made payable is more properly designated as the *beneficiary*. A policy may under certain circumstances be transferred to a third person, who is then called the *assignee*.

Section 2. Parties and Forms of Contract.

§ 5. **Who may be an insurer?** At common law any per-

(3) Sanford v. Insurance Company, 12 Cush. (Mass.) 541.

son could become an insurer. Today practically all of the business of underwriting insurance is done by corporations, and in some states, by statute, only corporations can issue insurance policies. These insurance companies are usually corporations organized for that purpose as a business for profit. There are several so-called fraternal orders or mutual benefit companies. These proceed in somewhat different ways, and in some respects vary from regular insurance companies, but the law that governs them is substantially the same as that with regard to regular insurance companies.

§ 6. Who may be insured? As far as the capacity of the insured is concerned there is no difference (with one important qualification mentioned below) between an insurance contract and any other contract. Since all contracts by an infant, save for necessaries, are voidable, an insurance contract taken out by an infant may be avoided at his option. If he avoids, however, he cannot, according to the better law, recover the premiums that he has already paid, unless the premiums will more than pay for the insurance that he has actually received (4). A policy taken out by an insane person is void if he was insane at the time of taking out the policy. Subsequent insanity will not avoid the policy, unless it prevents the performance of conditions necessary to keep the policy alive (5).

§ 7. Must contract be in writing? Although the contract of insurance is generally in writing, it is not essen-

(4) Johnson v. Insurance Co., 56 Minn. 365.
(5) Klein v. Insurance Company, 104 U. S. 88.

tial that it should be so. It is sufficient if the terms are definitely agreed upon and the risk assumed by the insurer. Nor need the premium actually be paid first, unless that is made a condition of the policy (6). Generally however the contract of insurance is in writing, and then it becomes effective only upon delivery (7).

§ 8. **Form of policy.** In many states the form of fire insurance policy has been fixed by statute, and all policies written in the state must be in that form. The form of policy that is most commonly required by these statutes is that which was established by the New York law and is known as the New York standard policy. It is this form which is used throughout this article as illustrating the various principles of fire insurance, and it is printed at length in the appendix. There are no legally established standard forms for the other branches of insurance.

Section 3. Insurable Interest.

§ 9. **In general.** If a person who had no interest in the property insured could take out a policy upon it, since under those circumstance he would, in return for the payment of a comparatively small premium, stand to win a very much larger amount by the destruction of the property, it is clear it would be for his interest that the property should be lost within the terms of the policy. To avoid this contingency it is obvious that, as a matter of public policy and protection of property, the right to insure must be limited to those persons who are so related to the property, that, if it were not for taking out

(6) Ruggles v. Insurance Co., 114 N. Y. 418; Insurance Co. v. Adler, 71 Ala. 516.

(7) Insurance Co. v. Babcock, 104 Ga. 67.

the policy, they would suffer a pecuniary loss by the destruction of it. This has occasioned the doctrine of requiring an insurable interest by the insured in the subject matter of the insurance. A person has been said to have an insurable interest in property "when he is so situated with reference to it, that, by its destruction, he will suffer an actual loss of money or legal right, or incur a liability" (8).

§ 10. **Fire insurance.** The general principle as thus stated is obviously reasonable. A few concrete examples may make the application of the rule clearer. The following are illustrations of what constitutes an insurable interest. The owner of property, even though it is mortgaged, and even though the mortgage is foreclosed, if he still has the right to redeem (9); a mortgagee (10); or a lienor; has an insurable interest. So a person who has a binding contract to purchase property has an insurable interest in that property. The interest need not be so direct as in the above cases in order to justify the taking out of a policy. Thus, a shareholder in a corporation has an insurable interest in the property owned by the corporation, since his right to profits may be affected by the destruction of the property (11). So a person engaged for a long term as superintendent of a factory has an insurable interest in the factory. But it must be a legal right. A mere hope or expectation does not constitute an insurable interest. Thus, an heir, even though it is morally certain

(8) Vance, Law of Insurance, p. 106.
(9) Savings Bank v. Insurance Co., 57 Conn. 335.
(10) Jerdee v. Insurance Co., 75 Wis. 345.
(11) Riggs v. Insurance Co., 125 N. Y. 7.

that the property will descend to him, has no insurable interest (12). And where a husband has no right in his wife's property, even though it is morally certain that she will continue to allow him to use it there is no insurable interest. Nor has a mere creditor an insurable interest in the property of his debtor, since he has no direct right in that property (13). But if the debtor is deceased, or a bankrupt, so that the creditor may proceed directly against the estate, then an insurable interest exists. And similarly, a husband, who has by law a right in his wife's property, has an insurable interest (14).

§ 11. **Same (continued).** A somewhat different aspect of the same principle is seen in the rule, that, where there is a legal liability which may be incurred by fire, there is an insurable interest. Thus a carrier or other person to whom are entrusted the goods of another person, in such a way that he is responsible for their safekeeping and would be liable to the owner if they were destroyed by fire, has an insurable interest in those goods (15). It is not necessary that the insurable interest shall be in existence at the time when the policy is taken out. It is sufficient if the policy is taken out to cover an interest intended to be obtained, and which is in fact held by the insured at the time of the loss. This is the case with floating policies to cover future acquired goods (16). On the same principle, a policy intended to cover the interest of another

(12) Baldwin v. Insurance Co., 60 Ia. 497.
(13) Creed v. Insurance Co., 101 Ala. 522.
(14) Insurance Co. v. Barracliff, 45 N. J. L. 543.
(15) Insurance Co. v. Railroad, 178 Ill. 64.
(16) Foley v. Insurance Co., 152 N. Y. 131.

person is sufficient, if that other person ratifies the taking out of the policy, even after the loss has occurred. The same general principles apply in marine insurance, as have been already stated with reference to fire insurance.

§ 12. **Life insurance: Legal obligation between parties.** A person has an insurable interest in the life of another person when, either because of a legal obligation or because of blood relation or marriage, there is a reasonable expectation of pecuniary advantage or gain from the continuance of the life. Illustrations of insurable interest resting on legal liability are as follows: A contracts with B to supply him with food and money for mining, and B is to give A one-half of the gains. A has an insurable interest in B's life (17). A creditor has an insurable interest in the life of his debtor, but the sum insured must bear some reasonable relation to the amount of the debt, present or expected; if the policy is for too large an amount it is void as being a gambling policy. The following insurance by creditors was held not to be too large: $10,000 on a $6,000 debt with expectancy of lending more (18); $2,000 on a $700 debt; and $3,000 on a $700 debt. On the other hand, $15,000 insurance on a $1,200 debt is bad as a gambling policy. On the same general principles, a woman has an insurable interest in the life of the man to whom she is engaged (19). In the fraternal orders, the rules of the order generally require the policies to be issued in favor of either relatives or persons dependent on the member. It

(17) Morrell v. Insurance Co., 10 Cush. (Mass.) 282.
(18) Curtis v. Insurance Co., 90 Cal. 245.
(19) Chisholm v. Insurance Company, 52 Mo. 213.

has been held that a fiancee may be brought within the category of dependent persons (20).

§ 13. **Same: Relation of blood or marriage.** Illustrations of the second kind of insurable interest in lives are husband and wife, and a sister supported or helped by her brother (21). Whether mere close blood relation, as a brother and sister, with no hope of pecuniary gain is a sufficient insurable interest is not agreed upon by the courts. The majority holds that it is not enough. It is sometimes held that the fact that a person has expended money in the support of another gives him an insurable interest in the life of that other, even though there is no obligation to pay back the sum thus expended (22). This, however, would seem bad as a matter of public policy, since it does not properly come within the test of insurable interest as defined above.

§ 14. **Same: Expectation of advantage.** It is generally held that the mere expectation of advantage, not based on any contract right or blood relation is not sufficient to give an insurable interest. Thus, a college which had been liberally benefited by the gifts of its founder, and which had strong expectations of future gifts, was held to have no insurable interest in his life (23). On the other hand, where a child was brought up by foster parents, although they did not adopt it so as to incur any legal obligation in regard to it, the child was held to have an insurable interest in the life of its foster father (24); and

(20) McCarthy v. Lodge, 153 Mass. 314.
(21) Lord v. Dall, 12 Mass. 115.
(22) Insurance Co. v. Kane, 81 Pa. 154.
(23) Trinity College v. Insurance Co., 113 N. C. 244.
(24) Carpenter v. Insurance Co., 161 Pa. 9.

a man married to a woman, who had, unknown to him, another husband still living from whom she had not been divorced, so that the second marriage was in reality a nullity, was nevertheless held to have an insurable interest in the life of the woman he believed to be his wife (25).

The same general doctrine of insurable interest exists in accident as in life insurance.

SECTION 4. ASSIGNEES AND BENEFICIARIES.

§ 15. Fire insurance: Assignees. If A, having a policy of insurance on his house, sells the house to B, this will not carry the policy to B, for insurance is a personal contract and is not regarded as an incident to the property, so as to pass with the transfer of it. This is one of the oldest principles in insurance law (26). Hence, if there is a fire after the sale by A to B, there can be no recovery on the policy. On the other hand, however, A may, when he sells the property to B, also assign the policy to B. Should the assignment require the consent of the company (27), there is really a new contract between B and the company, which is now based on B's insurable interest, and any subsequent act by A, is, so far as B's rights are concerned, immaterial. Thus, in a late case involving this principle, A's policy provided that if the insured without the consent of the company should mortgage the property, the policy should become void. A

(25) Insurance Co. v. Paterson, 41 Ga. 338.

(26) Lynch v. Dalzell, 4 Bro. P. C. 431.

(27) The New York Standard and most other policies specifically require the consent of the company to an assignment. See Appendix E, line 59.

mortgaged without the consent of the company, and later sold the premises to B and assigned the policy to B with the consent of the company; later there was a fire, and, when B sued the company, the company set up the existence of the mortgage made by A without its consent. This was held to be no defense, for the policy was forfeited only if the insured *should* mortgage, and B, the present insured, never had mortgaged, and what A did could not affect B's rights on what was substantially a new policy (28). On the other hand, where, on exactly the same facts, the policy had a clause that if the property *is* encumbered, the policy shall be void, it was held that B could not recover since that clause specifically applied to the condition of the property at the inception of the policy (29).

§ 16. **Same: Assignment to mortgagee.** It is possible for A still to retain the ownership of the property and at the same time assign the policy, in the sense of making it payable to B. This is frequently done to secure a mortgage. If the company consents, B now has a vested interest in the policy, and the company cannot, in the event of loss, pay the face of the policy to A without rendering itself liable to B (30). But the policy still rests on A's insurable interest and consequently, if anything is done by A which forfeits the policy, B has no right to recover (31). The principles discussed in this subsection and the preceding one are both illustrated by this case: A owned

(28) Insurance Co. v. Munns, 120 Ind. 30.
(29) Ellis v. Insurance Co., 32 Fed. 646.
(30) Hathaway v. Insurance Co., 134 N. Y. 409.
(31) App. E, ll. 36-74.

property and took out a policy on it. He sold the property to B and assigned the policy to B, with the consent of the company. B then mortgaged back the property to A, and directed payment to be made to A as his interest should appear. B later violated the policy. Subsequently a fire took place. It was held that there could be no recovery on the policy; none by A in his own right, because it was no longer his policy, since it was based now on B's insurable interest; nor could there be a recovery by A, as the assignee of B, because B had by his violation forfeited the policy (32). This case shows that, under such circumstances, an insurance policy taken out by the mortgagor and made payable to the mortgagee is no great protection to the latter, since it may be forfeited by any act on the part of the mortgagor. To provide for this difficulty, the standard insurance policy contains a clause which provides in effect that, when a policy is made payable to the mortgagee, it shall not, so far as his interest is concerned, be forfeited by any act committed by the mortgagor (33).

§ 17. Same: Consent of insurer to assignment. The consent of the company is necessary only to a complete assignment. The appointment by A of B as his agent to collect (34), or a pledge of the policy, or an agreement to assign (35), is not within the clause that requires the consent of the company. This clause also has no application

(32) Smith v. Insurance Co., 120 Mass. 90.

(33) App. E, ll. 121-128.

(34) Minturn v. Insurance Co., 10 Gray (Mass.) 501.

(35) Insurance Co. v. Morrison, 11 Leigh (Va.) 367.

to an assignment of a claim against the company after loss.

§ 18. **Fire insurance: Beneficiaries.** The principles that have been stated above with reference to the rights of B, as assignee of a policy, also apply where the policy is on its face made payable to B as beneficiary. He has a vested right to the proceeds, but it is still A's policy, and if A does anything to forfeit the policy, B cannot recover (36).

§ 19. **Life insurance: Assignees.** With certain modifications, the principles already discussed as to the rights of assignees and beneficiaries in fire insurance, also apply to life insurance. The insured may assign his policy and the assignee acquire a vested interest, but one which is liable to be divested if the insured forfeits the policy. In some jurisdictions (37) there is a further requirement that the assignee of a life policy must also have an insurable interest, but in most jurisdictions it is held that, if the policy is taken out by the insured in good faith, he can assign it to whom he will, it being obvious that he may be relied on for his own sake not to assign it to an improper person.

In the jurisdictions above mentioned, where the assignee is required to have an insurable interest; if the policy is assigned in good faith and the assignee have no insurable interest, the policy is not void. The assignee can recover back the premiums paid by him, and the balance of the policy goes to the estate of the deceased (38).

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(36) Grosvenor v. Insurance Co., 17 N. Y. 391.

(37) Indiana, Kansas, Kentucky, Missouri, Pennsylvania, Texas.

(38) Insurance Co. v. Armstrong, 117 U. S. 591.

In any case, if an insurance policy is taken out by A on his own life and at once assigned to B, who has no insurable interest, so that it is clear that the whole transaction is simply a scheme to let B do indirectly what he could not do directly, the policy is bad (39).

§ 20. **Life insurance: Beneficiaries.** The same difference of opinion that prevails as to whether or not the *assignee* of an insurance policy need have an insurable interest, also prevails on the question whether or not the *beneficiary* need have an insurable interest. The better rule is that he need not have. Like the assignee, he has a vested interest of which he cannot be deprived without his consent. So where a husband took out a policy on his own life payable to his wife, and later surrendered the policy, forging a release in his wife's name, it was held that she could still hold the company on the policy (40). But it is to be noted that the policy is still subject to all of the conditions, among which is the obligation to pay the premiums as they fall due. Hence, in a case similar to the above, where the insured's wife failed to keep up the premiums because of the fraud of her husband, the policy was nevertheless held to be forfeited (41). The beneficiary in a certificate issued by a mutual benefit association has no vested right, and it may be changed at the will of the person insured (42). The same rule of course obtains with the ordinary policy, where the power to change the beneficiary is expressly reserved in the policy.

(39) Warnock v. Davis, 104 U. S. 775.
(40) Whitehead v. Insurance Co., 102 N. Y. 143.
(41) Schneider v. Insurance Co., 123 N. Y. 109.
(42) Martin v. Stubbing, 126 Ill. 387.

§ 21. **Same: Controverted case.** The following kind of a case has been the subject of much discussion and difference of opinion in the courts. Suppose the husband takes out a policy on his own life payable to his wife, and the wife dies before the husband, leaving all her property and rights to her child, C, and then the husband dies. Who gets the proceeds of the policy; the executor of the husband; or C, who claims under the wife? If the policy on its face is made payable to the wife, her executors, administrators, and assigns, the cases generally agree that C would win (43). This would clearly be the case if it was made payable to the wife, and on her death to C. But if it is made payable simply to the wife, there is more doubt. It is generally settled that, if it is an endowment policy, the interest of the beneficiary is purely personal and ends on her death. If it is a straight life policy, most courts hold that the interest of the beneficiary may be transferred by her on her death as she desires, and consequently, in the case first put, in most jurisdictions C, who claimed under the wife's will, would prevail as against the executors of her husband (44), although there are many decisions to the contrary.

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(43) Millard v. Brayton, 177 Mass. 533.

4) Harley v. Heist, 86 Ind. 196.

CHAPTER II.

REPRESENTATIONS, CONCEALMENT, AND WARRANTIES.

SECTION 1. REPRESENTATION AND CONCEALMENT.

§ 22. **Marine insurance.** Because of the peculiar character of the contract of insurance, the most striking feature of it being the payment of a comparatively small premium, in return for which a disproportionately large sum may be obtained upon the happening of the contingency insured against; and because the facts with regard to the subject matter of the insurance were peculiarly within the knowledge of the applicant; the rule was at the earliest period enforced by the courts in marine insurance, that the contract was one of the utmost good faith, "uberrimae fidei," on both sides. They consequently held that it was the duty of the applicant for insurance to disclose fully to the underwriter all facts that might reasonably be likely to influence him in determining whether or not he would issue the policy. A concealment or misrepresentation of a material fact gave the insurer a defense to an action on the policy, and the good faith of the insured made no difference, if in fact his statement was not substantially true and all material facts were not disclosed. A material fact was at an early date defined by the court as any fact which, if known to the insurer, might

have led him to decline the risk altogether or to insure only at a higher premium; it is not necessary that the loss should be caused by the particular condition concealed or misrepresented (1).

§ 23. **Fire and life insurance in general.** The same general principles apply to fire and life insurance. Owing, however, to different methods adopted in these classes of insurance, the rule has been modified in its application. In marine insurance, the applicant for insurance went to the company and asked for the issuance of a policy, and the reasonableness of requiring him to state all the facts is obvious. In the case of fire and life insurance, this is not the situation. The person who applies for either of these two kinds of insurance is given a long list of questions in connection with his application for insurance. These questions he must answer before the company will issue the policy. In addition thereto, in most cases, the subject matter of the risk, whether it is a structure or a life, is carefully inspected by representatives of the company, and it frequently has other independent sources of information. For these reasons the rule has arisen in life and fire insurance that the insured may fairly suppose, that, if the company wants any information on any given point, it will ask for it, and if it does not ask, the insured may conclude that either the company knows of the facts or else that it does not regard them as being material (2). Thus, on such matters in fire insurance as the situation or character of the structure, the uses to which it is put, the

(1) Carter v. Boehm, 3 Burrows, 1905.
(2) Burritt v. Insurance Co., 5 Hill (N. Y.) 188.

methods of heating and lighting, the existence of liens and incumbrances, and many other material questions, the insured need say nothing unless asked (3). So, in life insurance, the insured, unless asked, need say nothing as to his habits, past career, diseases, or occupation.

§ 24. **Qualification of ordinary rule.** The foregoing rule has the natural and common sense limitation, that, if there is a fact that is obviously material, as defined above, but which at the same time is so peculiar and unusual in its nature that the insured cannot fairly expect the company to make inquiries along that line, then the failure to disclose will avoid the policy. Thus, where, after the insured had made his application but before the policy was issued, the building was burned, his failure to disclose was held to avoid the policy (4). So, where in life insurance A sent in his application but, before the policy was issued, he became dangerously ill in such a way that he must have known that it would effect the issuance of the policy, his failure to disclose his severe illness was held to avoid the policy as a concealment (5). On the other hand, if the change in circumstances does not take place until after the company is bound by the issuance of the policy, it makes no difference if the facts then occurring are disclosed or not, for obviously, since the company is bound, the knowledge of the facts cannot in any way better the company (6). And the same principle applies where the policy is not issued, but where the company has, by a

(3) Satterthwaite v. Insurance Co., 14 Pa. 393.
(4) Wales v. Insurance Co., 37 Minn. 106.
(5) Whitley v. Insurance Co., 71 N. C. 480.
(6) Assurance Co. v. Insurance Co., 52 Conn. 576.

binding contract, agreed to issue the policy, and for the same reason.

§ 25. **Existence of peculiar facts.** Whether, in cases of such peculiar facts that it is not fair to infer, from the failure of the company to ask, that it either knows or does not care about them, the applicant must disclose the truth at his peril, or whether it is enough that he acts in good faith, though unreasonably, in believing that the company does not want to know, is a question on which the courts are divided. The analogy of marine insurance would seem to lead to the conclusion that he must disclose these facts at his peril, but the tendency of later decisions is in the opposite direction. Thus, where A applied for a policy of insurance on his life and was at the time an embezzler to a large amount, a fact which he did not disclose to the company, Judge Taft held that if the jury found that the applicant did not conceal this fact for fear of being rejected or to defraud the company, but because he in good faith did not believe it would make any difference to the company, then he could still recover on the policy, even though in fact the company would not have issued the policy had it known that he was an embezzler (7). The judge also pointed out, however, the practical qualification that the more clearly material such peculiar facts are, the stronger will become the inference in any given case that the insured concealed them in bad faith, and with an intention to defraud the company. Under such circumstances, of course, the policy would be avoided, for it is clear, as a general principle, that if the applicant

(7) Insurance Co. v. Mechanics Bank, 72. Fed. 413.

makes an intentionally false statement, whether asked for or not and even whether ordinarily material or not, if it in fact influences the company in issuing the policy, there can be no recovery, not because of any peculiar insurance rule in regard to concealment or misrepresentation, but on the general principle that fraud renders any contract voidable at the option of the party defrauded.

§ 26. **Answers of insured must be substantially true.** Coming now to the list of questions put by the company, it is no defense to the company in an action on the policy, that the statements made by the insured in answer to the questions are not literally true. It is sufficient if the insured answers with substantial accuracy, and, in construing the questions and answers, the language used will be given its ordinary meaning as used by business men, and not any technical meaning that might possibly be attached to it. Thus, in a fire insurance application, the question was asked "Are you the owner of the building to be insured?" and the applicant said "Yes;" in fact the building was owned by his wife. It had been given to her by her father, with the understanding that if the insured, her husband, worked off the mortgage, she would convey the property to him, and he had lived there several years and already worked off a large part of the mortgage. His answer was held to be substantially correct, and no ground of defense to the company (7a). So, where the question was put "For what purpose is the building occupied and by whom?" and the answer was "By the applicant for the manufacture of lead pipe only," it was held that the

(7a) Insurance Co. v. Fogelman, 35 Mich. 481.

fact that he also used the building to make reels upon which to wind the lead pipe, was not a misrepresentation or concealment, since that could fairly enough be regarded as a part of the business of manufacturing (8). So, in life insurance, where the question was, "To what extent do you use alcohol?" and the answer was "None," the policy was not avoided for misrepresentation by showing a reasonable occasional use (9).

§ 27. **Same: Good faith not enough.** On the other hand, where a definite question is put, mere good faith on the part of the applicant is not enough, if the answer is materially false. Thus, where the applicant stated, in answer to a question, that he already was carrying $200,000 worth of insurance, while he really only had $30,000, the policy was void for misrepresentation, even though the statement was made by an agent who honestly believed it to be true (10). And the general principle is that the insured is responsible for the acts of his agents, both as to concealment (11) and misrepresentation. But, of course, he must be really his agent, and the mere statement in the policy that any person concerned in the policy is the agent of the insured and not of the company will be disregarded, if in fact he was really the agent of the company (12).

§ 28. **Volunteered information.** In connection with the point just discussed, it is necessary to notice an im-

(8) Collins v. Insurance Co., 10 Gray (Mass.) 155.
(9) Grand Lodge v. Belcham, 145 Ill. 308.
(10) Armour v. Insurance Co., 90 N. Y. 450.
(11) McFarland v. Insurance Co., 6 W. Va. 425.
(12) Kausal v. Insurance Co., 31 Minn. 17.

portant limitation. As has already been said, the insured must answer accurately all questions put. But if, after answering, the insured volunteers further information, this is not treated as an answer to the questions but as being something thrown in by the insured, and the policy is not avoided, even if the statement is false, unless it actually misleads the company. Thus, in an application for life insurance, the following question was asked: "Has father or mother . . . died or been afflicted with consumption. . . . If so state full particulars of each case." The answer was "No. Father died from exposure in water, age 58." It was held that the "No" was alone responsive to the question, and that the rest was mere surplusage and would not avoid the policy, unless it could be shown to be material as well as false (13). So, where the clear purpose of the question is not to get information as to the risk, but as to some collateral point, the false answer will not avoid the policy. Thus, where the question was "State definitely to whom you wish the benefit made payable and relationship to you," and the insured answered, "To my wife, Emily Louise Vivar," it was held that the only purpose of this question was to ascertain to whom the policy should be made payable, and the fact that the beneficiary was not his wife was held not to be material (14).

§ 29. Incomplete answers. A similar principle applies where the applicant gives an answer which is obviously not complete. This puts the company on inquiry, and, if

(13) Buell v. Insurance Co., 2 Flippin (U. S.) 9.
(14) Vivar v. Supreme Lodge, 52 N. J. L. 455.

it takes the answer as it is, it cannot complain because of the lack of sufficiency or accuracy. Thus, where in an application for a policy of fire insurance the question was asked, "Is the property encumbered and if so for what sum?" and the answer was, "No; are mortgagees in possession and other encumbrances existing;" the company, in a later action on the policy, was not entitled to rely on the fact that there were other encumbrances, the amount of which had not been stated, for it was obvious from the face of the answer that there were other encumbrances, and, if the company did not see fit to make further inquiry, it had no one to blame but itself (15). On the other hand, where the answer does not show on its face its insufficiency, of course the company is really misled and may set up as a defense the failure to disclose fully. Thus, compare with the preceding case, the following: In an application for fire insurance the question was asked: "Is the property mortgaged or otherwise encumbered, and to what amount?" The answer was, "To A for $800." In fact there was another mortgage to B for $700. The failure to disclose this was rightly held to void the policy, for in this case there was nothing in the answer to show that all the facts had not been stated (16).

§ 30. **Statements of opinion.** A further distinction must be noticed, between a question of what may be called an external fact and a mere matter of opinion. In the latter kind of question, if the insured states his belief in good faith, that is all that can be required, even though his

(15) Nicholl v. Insurance Co., 1 Allen (Mass.) 63.
(16) Towne v. Ins. Co., 7 Allen (Mass.) 51.

belief may be unreasonable. The common case is that of asking the value of the property and it is well settled that, even though the answer of the insured may be unreasonably large, if it is his bona fide estimate of the value of the property, there is no ground for claiming a misrepresentation (17). Of course if the insured intentionally overvalues the property, so that he is not really stating his own opinion, that will avoid the policy, except where the company knows that it is overvalued and still accepts the risk; or, perhaps, in the case where the property is in reality worth the amount given by the insured (18).

§ 31. **Materiality of representations.** Ordinarily the question, whether the fact concealed or misrepresented is material, is to be settled by the jury, and the company must show that it was in fact such. Thus, if it appears that the company would not have acted differently, even had it known of the fact concealed, it clearly cannot claim it to be material (19). But the parties may, by their contract, specifically agree that the facts are material, and that of course settles it (20). The fact that the company puts certain questions and the insured answers them is strong evidence that they are material, but it is not necessarily conclusive (21).

§ 32. **Promissory representations.** A representation is necessarily of facts present or past. There can be no such thing as a misrepresentation or concealment of a future

(17) Insurance Co. v. Vaughan, 92 U. S. 516.
(18) Insurance Co. v. McDowell, 50 Ill. 120.
(19) Pelzer v. Insurance Co., 41 Fed. 271.
(20) Gerhauser v. Insurance Co., 7 Nev. 174.
(21) Vivar v. Grand Lodge, 52 N. J. L. 455.

fact. Hence, where the insured in his application makes a statement as to something in the future, unless this can be construed as a binding promise or as a warranty, it will be of no effect, even if the insured afterwards departs from his statement as to what he is going to do (22).

Section 2. Warranties in General.

§ 33. Distinction between representation and warranty. The difference between a representation and a warranty is fundamental and far reaching, and must be constantly borne in mind. A representation is a statement leading up to the making of the policy, but not in itself a part of it. A warranty is an integral part of the policy, on the pertormance of which the validity of the policy depends. A representation need be only substantially correct, and it avoids the policy if false, only if it is so on a material point, that is, one that influences the company in underwriting the policy. A warranty must be exactly performed, and the question of its materiality makes no difference, since the parties have by their contract made it a part of the policy and a condition of its validity.

§ 34. Interpretation of ambiguous clauses. As a general principle on the question whether the given statement is a representation or a warranty, the rule is that if there is a fair doubt on the point, the court will treat it as a representation. This is only just. In the first place, there is a general principle of law against construing an instrument in such a way that it will impose a forfeiture of rights regardless of any real hurt, unless it is clear that

(22) Insurance Co. v. Hoffman, 128 Ind. 250.

such was the intent of the parties. In the next place, the company draws up the policy, and it ought to make it clear that any given clause on which it relies as a technical warranty is in fact such. Finally, holding a statement to be a representation does not mean that the insured can recover at pleasure. If it can be shown that, treating the statement as a representation, it was not substantially true and that the company was misled thereby to its prejudice, the latter can still prevent a recovery. The justice of this rule is so strong that in many states statutes have been passed, which, in varying degrees, provide in substance that in all cases warranties shall be treated as representations and shall avoid the policy only if they are material and substantially false (23).

In marine insurance, probably every statement which appeared on the face of the policy relating to the risk was, under the older law, and to a considerable degree still is, construed as a warranty. In both fire and life insurance there is a very marked tendency to relax this rule.

§ 35. **Express language of policy.** If the policy, life or fire, expressly says that the insured "warrants" certain things, or if the policy provides that it is a "condition" of it that certain things shall be as stated, or if it provides that the policy "shall be void" (24) if certain things are done or not done, there of course can be no question. For a consideration of the more frequent clauses of this kind, see §§ 61-80, below. If the insured does not comply

(23) Such states are California, Georgia, Iowa, Kentucky, Maine, Maryland, Massachusetts, Michigan, Minnesota, Missouri, Montana, New Hampshire, North Dakota, Ohio, Pennsylvania, South Dakota, Virginia.

(24) App. E, l. 29.

with these requirements, the policy by its very terms is void.

SECTION 3. INCORPORATION OF OTHER DOCUMENTS AS WARRANTIES.

§ 36. **General principles.** A more difficult question arises when the character of the statement is not specifically declared. In this connection it is to be noticed that not all of the phrases that appear on the face of the policy are necessarily warranties, and conversely that the warranty need not necessarily appear on the face of the policy. Policies frequently refer to other documents, especially the application or survey of the building if there is one, and state that these other documents are to be treated as and deemed a part of the policy. Whether the statements in the application or survey thereby become part of the policy so as to become warranties, depends on how the policy refers to the application or survey, and for what purpose this reference is made. It therefore becomes necessary to examine carefully the language of the policy which refers to and incorporates the application. Thus, where a fire insurance policy referred to the survey in these words: "$4,000 on the merchandise contained in the stone building . . . more particularly described in the application and survey filed No. 928 in this office," it was held that the survey was obviously referred to only for the purpose of describing the building, and that consequently the language of the survey would be treated merely as a representation and not as a warranty (25).

(25) Snyder v. Insurance Co., 13 Wend. (N. Y.) 92.

So, where in the policy *certain* answers and *certain* surveys are referred to and expressly made warranties, the inference of course becomes clear that other surveys referred to are not made warranties but merely representations (26).

§ 37. **Conflicting language.** Another class of cases is this: Suppose that the policy refers to the application and survey in one place as a warranty, and in other places as a representation or description; or suppose the policy refers to the application or survey as a warranty, but the application or survey declares itself to be a representation simply. If one bears in mind the general principle already stated, that the courts, in case of doubt, lean against holding a phrase to be a warranty, the result reached in this case is easily understandable. The courts hold that, under such circumstances, it not being clear on looking at all the documents in the case that the company meant to treat the survey or the application as a warranty, they will treat it in a way most favorable to the insured, namely, as a representation.

§ 38. **Same: Illustrations.** Thus, in a leading case on this point, the policy contained these passages: "Special reference being had to the assured's application and survey No. 1462 on file, which is his warranty and a part hereof. . . . If an application . . . is referred to in this policy, such application . . . shall be considered a part of this policy and a warranty by the assured, and if the assured in a written or verbal application makes an erroneous representation . . . this policy

(26) Wilson v. Insurance Co., 4 R. I. 141.

shall be void," and the application ended thus, "the said applicant hereby covenants and agrees with the said company that the foregoing is a just, fair, and true exposition of all the facts and circumstances in regard to the . . . risk, so far as the same are known to the applicant and are material to the risk." Speaking on the question, whether the result of these clauses was to incorporate the application as a representation or as a warranty, the Supreme Court of the United States said: "If such [the incorporation of the application as a warranty] was the purpose of the company, why did it not stop with the express declaration of a warranty? Why did it go further and incorporate into the policy the provision for its annulment, in the event the assured did make an 'erroneous representation or omit to make known any fact material to the risk'—language inconsistent with the law of warranty? Still further, why did the company make the application a part of the policy, and thereby incorporate into the contract the covenant of the assured, not that he had stated every fact material to the risk or that his statements were literally true, but only that he had made a just, true, and fair exposition of all material facts so far as known to him? . . . When a policy of insurance contains contradictory provisions of this character, so framed as to leave room for construction rendering it doubtful whether the parties intended the exact truth of the applicant's statements to be a condition precedent to a binding contract, the court should lean against that construction which imposes upon the insured the obligation of a warranty" (27).

(27) National Bank v. Insurance Co., 95 U. S. 673.

Another case that illustrates the same principle is this: At the end of the application appears the statement that the insured *warrants* the foregoing answers to be true. In the policy appears this clause: "This policy is based upon the *representations* contained in the assured's application, each and every statement of which is hereby specifically made a warranty and a part hereof." The court held the language in this case also to be conflicting and consequently construed the language as being a representation simply (28).

§ 39. **Incorporation must be by reference in policy.** It must be noticed that, in order to incorporate the application or survey, the incorporation must be done in the policy; it is not enough that the application should declare itself to be a warranty and a part of the policy. The policy must itself refer back to and incorporate the application as a warranty, or else it is treated as a mere representation. Thus, in Day v. Life Insurance Co. (29) the court said: "Though the proposal and application contains the agreement . . . that the answers . . . shall be the basis . . . of the policy between the insured and the company, yet the policy does not directly or indirectly so declare, and it will be assumed that all previous negotiations have been superseded and that the policy alone expresses the contract of the parties." In some states it is required by statute that all warranties must appear on the face of the policy or be physically attached thereto.

§ 40. **Construction of document incorporated.** Assuming now that the policy has referred to and incorporated

(28) Rogers v. Insurance Co., 121 Ind. 570.
(29) 39 N. J. L. 89.

the application or survey, not as an express warranty in all its statements but simply as a part of the policy, so that we have only the policy to consider; the next question is, which of the statements there appearing are representations and which are warranties—for, as already stated, not all of the statements in the policy or application incorporated therewith are necessarily warranties. There is considerable confusion in the decisions of the courts on this very important point, but in general it may be said that there are three classes of cases.

§ 41. **Same: First class of cases.** First, if the words used are those that state what it is that is being insured, so that if those words were struck out it would be impossible to know what was the subject matter of the policy, those words are warranties. Thus, where the insured took out the policy on his "paper mill" the words "paper mill" were held to be a warranty (30). Because, if the structure was not a paper mill, the parties had never agreed to insure anything. So, where the policy was on a "stock of trade consisting of non-hazardous merchandise," the words just quoted were a warranty; if they meant other merchandise, it would not be insured (31).

§ 42. **Same: Second class of cases.** The second class of cases is where the property is already sufficiently identified, and other phrases are introduced into the policy with the idea of getting a further collateral description. These words are held not to be warranties, but mere representations, and hence to avoid the policy only if they are both

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(30) Wood v. Insurance Co., 13 Conn. 533.
(31) Richards v. Insurance Co., 30 Me. 273.

material and substantially false. Thus, A took out a policy on his barns. In the policy occurred the words: "All the above barns are used for hay and stabling." It was held that these latter words were merely a further incidental description of the property and were not warranties (32). So, where the policy was "on two large frame ice houses . . . all used for the storage of ice," the court said that the latter words were not warranties but "descriptive of the business ordinarily done in them" (33).

§ 43. **Same: Third class of cases.** The third class of cases is where the words are not necessary to set forth the subject matter of the insurance, as in the first class of cases, but, on the other hand, cannot properly be regarded as merely additional incidental statements concerning the property covered as in the second class; in other words, where it is clear that they are incorporated in the policy for the purpose of giving the company direct additional information as to the character and nature of the risk that it is assuming. Under these circumstances, the words will be treated as warranties and not as representations, with the consequence that, if broken, the breach will, irrespective of materiality, make the policy voidable. It is naturally sometimes difficult to draw the line between words falling in class two and those falling in class three, and the decisions on these questions are not all reconciliable. Some cases will serve to illustrate how the courts have approached this question.

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(32) Billings v. Insurance Co., 20 Conn. 139.
(33) Dolliver v. Insurance Co., 131 Mass. 39.

§ 44. **Same: Illustrations of language held a warranty.** In Fowler v. Aetna Insurance Co. (34), the policy was executed on the stock in trade consisting of certain goods "contained in the two story frame house *filled in with brick* situated at No. 152 Chatham street." It appeared that the house was in fact wooden with hollow walls, and was not filled in with brick. The court instructed the jury that, irrespective of the question whether or not this was a material alteration in the risk, the policy was void because of the fact that the words "filled in with brick" were a warranty and had not been complied with by the assured. In the case of Burleigh v. Insurance Co. (35), among certain incidental provisions and after the description of the property, there appeared this statement: "all contained in the frame storehouse with slate roof, . . . detached at least 100 feet, on the east side of Lake Champlain, in the town of Shoreham, Vermont." It appeared that at the time the policy was issued there was a small building about 75 feet distant from the storehouse. The court held that the statement "detached at least 100 feet" was a warranty. They said, "we cannot hold it to be a mere description of the building for the purpose of identifying that personal property insured contained within it. The phrase is not adapted to any such purpose. It adds nothing to the identity of the storehouse already sufficiently described by its ownership and situation on the lake." In Stout v. Fire Insurance Co. (36), the policy purported to be "on the five story brick building known

(34) 6 Cowen (N. Y.) 673.
(35) 90 N. Y. 220.
(36) 12 Iowa, 371.

as the Lawrence block, occupied for store below, the upper portion to remain unoccupied during the continuance of this policy." In this case also, the court held that the phrase "occupied for store below" was in law a warranty, since it could not fairly be regarded as a mere collateral description of the building as it had already been sufficiently identified in other ways.

§ 45. **Same: Illustrations of language held not a warranty.** On the other hand, where the phrase in question was not incorporated with others that were plainly meant as warranties, but was inserted in the midst of phrases that the court regarded as simply descriptive, the courts have held it to be merely a representation and not a warranty. Thus, in Frisbie v. Insurance Co. (37), the application, which was incorporated in and made a part of the policy, contained these words: "Application of Orton Frisbie . . . for insurance against fire . . . in the sum of $1,500, to-wit, on his stock of merchandise $1,200, on dry goods kept in a frame plastered storehouse 24 by 24 feet, one and a half stories high; merchandise kept on first floor and groceries in the store rooms and cellar; said store attended by applicant and clerk; *clerk sleeps in store*; one stove in said store room," etc. It was contended by the defendant that the words in italics were a warranty. The court held that they were not, that it was clear that the various phrases in the midst of which the phrase in question was inserted were mere descriptions, and that there was no sufficient reason to distinguish this phrase from the others. Thus, in Kingsley v. Insur-

(37) 27 Pa. 325.

ance Co. (38), the policy provided for insurance "on the paper mill and permanent fixtures $1,200; on the machinery $800, *on condition that the applicant take all risk from cotton waste*, situated as described in the application, reference being had to the application of the said Kingsley for a more particular description and as forming a part of this policy," etc. The court held that the words in italics were not warranties, even though they purported to be a condition. It said that the position in which they were inserted in the policy, and the fact that there was nothing required for the insured to do or to omit to do, by way of performing the supposed condition, made it clear that the legal meaning of those words could be only that they were to be regarded as expressing the intention of the insurance company not to cover a loss originating in cotton waste, but nothing more than that.

Section 4. Extent of Warranty.

§ 46. **Fire insurance.** Assuming that in any given case the phrase is a warranty, and therefore to be exactly performed regardless of materiality, a further question remains, namely, what is fairly meant by the parties to be the extent of the warranty. In answering this question, the court will look to the purpose of it and will not hold the insured to an absolutely literal compliance, if it can fairly see that any other construction of the warranty will really fulfill the purpose that the parties had in mind at the time of making it. Thus, in the case of Burleigh v. Insurance Co. (note 35, above), the court held that while

(38) 8 Cush. (Mass.) 393.

the words "detached at least 100 feet" were a warranty, that the warranty was satisfied by showing that the building was deached at least 100 feet from any other building likely to endanger it, it being clear that that must have been the purpose for which the warranty was inserted; so that the mere fact that there was a structure within 100 fee was held not to affect the policy, when it was shown that it was not of a kind that would endanger the building insured. A similar principle was applied in the case of Mickey v. Insurance Co. (39), where the following language appeared in the application, which was incorporated with and made a part of the policy: "Are your chimneys, fireplaces, stoves, and pipes all well secured and will you engage to keep them so?" Answer, "Yes." The stove not being required for use during the summer months was usually removed. With the intention of removing it, the insured took down the stove pipe in the second story chamber and placed a bed over the hole in the floor through which the pipe passed, but he neglected to remove the stove. A few days later, a visitor complaining of the cold, a fire was built in the stove, the owner forgetting that the pipe had been removed. A fire ensued from which the building was burned, and, in an action on the policy, the company set up the breach of warranty above quoted. The court held that in construing the warranty in question the purpose of the parties must be looked to, and that the purpose was clearly that the insured should keep his stove pipes, etc., in good and careful condition as a prudent householder would, but that it did not forbid

(39) 35 Iowa 174.

the removal of the stove-pipe under the circumstances where a prudent householder might well remove it, which would naturally be the situation during the summer. Consequently the insured was allowed to recover on the policy.

§ 47. **Life insurance: General purpose of questions regarding health.** This general principle of construing the warranty in the light of the purpose that it was meant to serve has a very important application in life insurance, where numerous questions are asked with reference to the general health of the insured, and as to whether or not he has suffered certain specified diseases. The principle in this class of cases is: that the purpose of asking the insured if he has had various diseases is to get information as to whether or not he is in good health and a good risk; that the company does not desire nor is it reasonable to expect the insured to encumber the application with a detailed recital of every time he has suffered in any degree with any of the complaints mentioned; that "disease" as used in the application means an illness sufficiently grave to affect to a really serious degree the health, and thus render it possible that the applicant is a less favorable subject than he otherwise would have been. Hence, if the insured warrants that he is in good health, the fact that at the time he was suffering from some minor complaint would not avoid the policy, if it did not really affect his bodily condition; for, as a matter of fact, no man is in perfect health (40). The same principle applies where more specific questions are put. Thus, in Wilkinson v. Insurance Co. (41), the following question, among others,

(40) Peacock v. Insurance Co., 20 N. Y. 293.
(41) 30 Iowa, 119.

was asked: "Has the party ever met with any accidental or serious personal injury; if so what was it?" Answer, "No." In an action on the policy the company proved that, several years prior to the taking out of the policy, the insured had fallen at a considerable height from a tree and was sick for some time as a consequence. The jury found, however, that that injury was only temporary and had passed off and did not cause any disease or exert any influence on the subsequent health of the insured; and, under these circumstances, the court held that there had been no forfeiture on the part of the insured and that the company had no defense. The same principle applies to questions as to specific diseases, as, for example, pharyngitis and pneumonia. In such cases the question was submitted to the jury whether the slight attack testified to really affected the insured, and a finding that it did not was held to be conclusive against the company.

§ 48. Same: Good faith insufficient, if answer false. On the other hand, some cases hold that if the disease is serious enough really to affect the health of the insured, then the policy is void if he answers the question in the negative, even though the answer is made in good faith. Thus, where the insured said that he did not have Bright's disease, the jury was instructed that if he had it to such a degree as to affect materially his kidneys, the policy was void whether he knew of the disease or not (42). Of course the same result would clearly follow in the case where he had had the disease and knew it, and said that he had not had it, as in the case of rupture (43).

(42) Insurance Co. v. Yung, 113 Ind. 159.
(43) Insurance Co. v. France, 91 U. S. 510.

§ 49. **Same: Specific questions.** The same principle applies, if the disease inquired about is one that is rather a symptom of some general bodily condition than a serious bodily affliction, in which cases the insured must answer "yes," if he has had the disease, whether he thinks it is serious or not. Thus, where the inquiry was made whether the insured had had "headaches, serious, frequent, or protracted," the lower court instructed the jury "that the temporary illness of the insured in the case of every day life, brought on by excessive exercise or overwork, is not embraced in the said application; but the answers in said application have reference to such diseases or ailments as indicate a vice in constitution or which is so serious as to have some bearing on the general health, conditions which, according to general understanding, would be called diseases." The upper court held that the question was clear and that the instruction of the lower court was wrong, and sent the case back for a new trial (44). A similar case was one in which the insured was asked whether he had ever had "chronic or persistent cough, or hoarseness, or spitting or coughing of blood," and he answered in the negative. It was held that if he had in fact been afflicted with spitting blood the policy was void on the ground that, as the question was a specific one, the amount of injury that the disease caused was put out of consideration (45).

§ 50. **Qualified warranties.** Another distinction that is to be kept in mind on the subject of warranty is this: If

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(44) Insurance Co. v. Simpson, 88 Tex. 333.
(45) Glutting v. Insurance Co., 50 N. J. L. 287.

in answering the questions, the insured qualifies his answers by stating that they are as nearly right as he can remember, this is sufficient, since it clearly shows that he is answering only according to the best of his knowledge; and the mere fact that a disease inquired for did exist, even to a serious degree, will not prevent a recovery on the policy, unless it can be shown that he did not answer in good faith (46). So, where on the application there was a printed statement at the foot of it, in which it was stated in substance that all that was required of the insured was good faith, and that his insurance could be jeopardized only by dishonesty or carelessness, it was held that warranties were simply statements in good faith, and that, in order to sustain a defense based upon a breach of such warranties, it would be necessary to show that not only the statements were in fact untrue, but that they were known by the insured to be so and were made by him with fraudulent intent (47).

§ 51. **Promissory warranties.** A further and very important distinction that is to be noticed, with regard to warranties, is the question whether or not the warranty relates only to the state of affairs at the time of taking out the policy, or whether it is so worded as also to amount to a warranty that the general state of affairs shall continue in the future. Frequently this question may be definitely settled by an examination of the terms of the policy. If it is clear by the language that the assured binds himself as to future actions, there can of course be no question. Thus, where the policy contained the following clause: "the as-

(46) Insurance Co. v. France, 94 U. S. 561.
(47) Fitch v. Insurance Co., 59 N. Y. 557.

sured hereby agrees to keep twelve pails full of water on each floor of said mill during the continuance of this policy,'' the court held that the assured had clearly bound himself to future action, and, unless he did in fact continue to keep twelve pails as aforesaid, his policy was void (48). So, in a life insurance policy, where the policy contained the following statement: ''I guarantee that I do not and will not practice any bad or vicious habits that tend to the shortening of life,'' it was held that the policy was void, where it was shown that the insured several years after the taking out of the policy became intemperate to an excessive degree (49).

§ 52. **Same: Implied limitations on warranty.** In other cases, although the policy does not state in so many words, it is clear enough upon an examination of it whether or not the warranty in question is for future action. Thus, in the case of Stout v. Insurance Co. (note 36, above), the court held that the language of the policy clearly distinguished between the stores and the upper portion; that, inasmuch as it was stated of the upper portion that it was *to remain* unoccupied, that bound the insured as to the future. But, since the policy stated as to the lower part of the building merely that it was ''occupied by stores'', that distinguished between present and future action, and they would not construe it to be a warranty that the building should continue to be occupied by stores.

In the case of Hosford v. Insurance Co (50) the application, which was made a part of the policy, contained the

(48) Garret v. Insurance Co., 20 U. C. Q. B. 200.
(49) Knight v. Insurance Co., 9 W. N. C. (Pa.) 501.
(50) 127 U. S. 399.

following questions and answers: "What material is used in lubricating or oiling the bearings and machinery? A. Tallow, lard, and machine oil. Q. Will you agree to use use only lard, or sperm and lard oil for lubricating; lard and tallow, or lard and machine oil? Will you agree to keep all the bearings and machinery properly supplied with oil? A. Yes. Q. Is smoking or drinking of spirituous liquors allowed on the premises? A. No." In an action on the policy, the company set up as a defense that, after the policy had been taken out, smoking and drinking was allowed on the premises, and alleged that it was a breach of the warranty. The court held that an examination of the questions noted above in the application showed that the company had clearly made a distinction between those words in which they saw fit to exact a definite promise of the insured in his answers to the questions, and those in which they did not; in other words, that, when they had not exacted a promise as to future action in regard to the prohibition of smoking and drinking, it must be held that it was satisfied merely with the warranty as to the condition in that regard at the time of the taking out of the policy.

§ 53. **Same: Ambiguous language.** In a large number of cases, however, it is impossible to draw so easily the line between present and promissory warranties. Under these circumstances, the general principle of construction is that the warranty will be held not broader than the company has clearly made it, and so, unless it is clearly a promissory warranty, it will be construed as merely a warranty of present conditions and not as to future action.

Thus, where the insured in terms of warranty described the stock insured as "a two story frame building used for winding and coloring yarn," it was held to be no warranty that it would continue to be used for that purpose (51). So, the insurance of a building as an "occupied dwelling house" is not a warranty that it will continue to be occupied (52). In this last connection, however, it is always to be borne in mind that, irrespective of any definite warranty of future use, the policy is void if the subject matter of the policy is so changed as to materially increase the risk.

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(51) Smith v. Insurance Co., 32 N. Y. 399.
(52) Insurance Co. v. Douglas, 58 Pa. 419.

CHAPTER III.

SPECIFIC REQUIREMENTS OF POLICIES.

§ 54. **Introductory.** Having considered the general principles of the making of the various contracts of insurance, and the important difference between representations and warranties, it will be necessary to examine the exact scope and effect of some of the more commonly found warranties or conditions in the various kinds of policies.

SECTION 1. MARINE INSURANCE.

§ 55. **Implied warranties.** Rather oddly, the three most important warranties in marine insurance are not expressed on the face of the policy at all, but are universally implied as arising from the dealings of the parties. The insured is held to warrant: first, that the vessel is seaworthy; second, that the vessel shall not deviate from the proper course; and, third, that the vessel is not engaged in an illegal transaction.

§ 56. **Warranty of seaworthiness: When applicable.** In considering the warranty of seaworthiness, it is necessary in the first place to distinguish between two kinds of marine policies: that is to say, the *voyage policy*, where the insurance is for a given voyage from one port to another; and the *time policy*, where the insurance is for a

stated period of time, regardless of where the vessel may be. It is everywhere agreed that the warranty of seaworthiness applies to the voyage policy. It is well settled in England that that warranty does not apply to a time policy, for the reason that at the inception of the policy the vessel may be in a place where it would be impossible to equip her in a way that would satisfy the warranty of seaworthiness. In the United States the rule varies in different jurisdictions. Apparently the generally adopted idea is that the warranty of seaworthiness applies, even in a time policy, if the vessel at the taking out of the policy is in a port where she can be equipped. Otherwise it does not (1).

§ 57. **Same: Extent of warranty.** The warranty of seaworthiness is not a "continuing warranty". That is to say, if the warranty is satisfied at the inception of the risk, the recovery is not barred if, through the negligence of the officers or seamen, the vessel subsequently becomes unseaworthy. The warranty implies that the vessel is properly equipped, provisioned, and manned for the voyage. This does not necessarily mean that at the inception of the voyage the vessel is then equipped to perform satisfactorily the entire voyage. One leading case will illustrate this limitation. A vessel was insured for the voyage, beginning on an inland river, down the river to the ocean, and then over the ocean to another port. When she began the river trip she had a sufficient equipment for that part of the trip, but not sufficient for the ocean. She took on enough to make her seaworthy for the ocean,

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(1) Hoxie v. Insurance Co., 7 Allen (Mass.) 211.

before beginning that part of her trip. It was held that the warranty of seaworthiness was satisfied, since, through every step of her journey, she was properly equipped for that part of it (2). On the other hand, it must be noted that, inasmuch as it is a *warranty* of seaworthiness, any breach of this warranty voids the policy, irrespective of the question whether or not the loss is traceable to lack of seaworthiness. Thus, in one case, a vessel was insured for a voyage and made the first few miles of her voyage short two hands of her regular equipment. These two hands she afterward procured, and then was later on lost through an entirely unrelated cause. It was held that there could be no recovery on the policy, because of the breach of the warranty of seaworthiness at the beginning of the voyage (3).

§ 58. **Warranty of non-deviation.** This warranty also applies only to voyage policies. In such policies the insured impliedly warrants that the vessel shall go, by the regular route, from the port named as the port of beginning to the port named as the port of termination, and that the voyage shall begin without unreasonable delay. Here, as with the warranty of seaworthiness, if the warranty is broken, the fact that the loss is in nowise due to this breach will not prevent the company from successfully resisting recovery. Thus, in a leading case on the point, a vessel was insured from Plymouth, Massachusetts, to the Newfoundland Banks, and then back to Plymouth. After reaching the Banks she ran out of bait, and made a five

(2) Bouillon v. Lupton, 15 C. B. (N. S.) 113.
(3) Forshaw v. Chabert, 3 B. & B. 158.

day trip to Newfoundland to procure bait. She then fished for several weeks on the Banks, and then sprung a leak and sunk. The insured was not allowed to recover on the policy, because of the breach of the warranty of no deviation (4). Of course if the deviation is necessary to avoid storms, or to put into a port for repairs (5), or where the vessel is driven from her course by a storm (6), the policy is not extinguished.

§ 59. **Warranty against illegality.** This warranty in one form or another exists in all branches of insurance. Its details will be discussed under the same head in fire insurance. The only peculiar qualification to note, in connection with marine insurance, is that an attempt to violate the revenue laws of another country by smuggling is probably not such illegality as will avoid the policy (7).

Section 2. Fire Insurance: Conditions Applicable Before Loss.

§ 60. **Introductory.** The conditions in a fire policy may be divided into two classes: first, those applicable before loss, relating to the condition of the premises, the conduct of the business, or other matters of a similar nature; second, those applicable after loss, relating to the presentation of proofs and similar questions These conditions are grouped separately in most policies and it will be easiest to consider them separately, taking first the conditions applicable before loss.

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(4) Burgess v. Insurance Co., 126 Mass. 70.
(5) Hall v. Insurance Co., 9 Pick. (Mass.) 466.
(6) Graham v. Insurance Co., 11 Johns. (N. Y.) 352.
(7) Planché v. Fletcher, 1 Doug. 251.

§ 61. Language of policy: Meaning of "shall be void." All fire policies contain a large number of provisions regulating the character of the risk. The policy generally provides that it "shall be void" (7a) if the insured shall do or fail to do the acts therein mentioned. Hence there can be no question that these requirements are warranties, upon the exact performance of which the validity of the policy depends.

The word "void", however, as used in insurance policies, means only voidable at the election of the company. It is well settled that the company may waive forfeitures, either expressly or by acts which recognize the policy as being in force. Further than this, it is held in some states that the policy is only suspended during the time when the condition is violated, and revives again on the condition being no longer broken, provided that the breach of the condition does not contribute toward the loss (8). This doctrine is held of course for the purpose of avoiding forfeiture of the policy, but, as has been already pointed out, while it is a well established principle that the court will not enforce a forfeiture unless it is clear that the forfeiture has been contracted for, there would seem no real doubt as to the language of the parties in such a case as this, and the general rule in this country is that, if there is an unwaived breach of any condition of the policy, the policy may be definitely voided at the option of the company, and not merely suspended (9). The requirements of the policies vary. For this reason it will not be possible to

(7a) This is the New York Standard form. App. E, ll. 29, 37.
(8) Lane v. Insurance Co., 12 Me. 44.
(9) Moore v. Insurance Co., 62 N. H. 240.

examine them all in detail, but the more important ones of the New York Standard policy may be taken as typical.

§ 62. Other insurance. Some forms of policies provide that the policy shall become void, if "the insured shall have or procure other insurance on the property covered by this policy." The purpose of such a provision is obvious. If the insured can take out several policies upon the same property, the chances for recovering more than the actual loss are greatly enhanced, and the moral risk for the same reason correspondingly increased, and it is to prevent this contingency that conditions against further insurance have been inserted in the policy. It is to be noted that there is no double insurance, unless the two policies cover the same interest. Thus, for example, a mortgagor and mortgagee may each take out insurance on the premises covered by the mortgage, without there being any double insurance.

§ 63. Same: Two views of meaning. The phrase quoted above, which is a very common one, has occasioned a great deal of difficulty in its construction. Suppose, for example, A takes out a policy having that clause in it, and then takes out on the same premises a second policy, also having that clause in it. Which policy is good and which bad, or are they both bad? It is arguable that, as the first policy provides that it shall be void if other insurance is taken out, the first becomes void at once upon the taking out of the second, and that hence there can be no recovery on the first (10). On the other hand, the argument can be turned around, and it can be said that, since the

(10) Stevenson v. Insurance Co., 83 Ky. 7.

second policy had a similar clause, that that policy, because of the prior existence of the first policy, never came into effect, and hence that the first is good and the second bad (11). This latter is the generally prevailing view, although the objection may be urged to either view that it is well settled that the word "void" in insurance policies means only voidable at the option of the company (§ 61, above). The New York Standard policy puts this matter beyond doubt by its language making the policy void, if other insurance, whether valid or not, shall be taken out on the property (12).

§ 64. **Increase of hazard.** The New York Standard policy provides that it shall be void, "if the hazard be increased by any means within the control or knowledge of the insured" (13). The courts have held that this does not apply to all acts that increase the hazard on the property insured, but only to those acts which make a permanent alteration in the degree of risk that the company is carrying. Thus, in one case, the insured used kerosene to kindle a fire, with the result of temporarily increasing the risk and in fact burning up the premises. The court held, however, that the condition as to the increase of hazard had not been broken, and that he could recover on the policy (14). Of course the increase of hazard may be of varying duration, and it would seem that if the act done by the insured is a reasonable one, that it will not violate this clause of the policy even though kept

(11) Insurance Co. v. Replogle, 114 Ind. 1.
(12) See App. E, l. 39.
(13) See App. E, l. 43.
(14) Angier v. Insurance Co., 10 S. D. 82.

up for some considerable time. Thus, in one case, the insured changed the bulkhead that gave him his water supply so that the water was cut off for a number of days and the risk of course increased. The court held that the policy was not void, if the alteration was done in a reasonable way (15). On the other hand, where the insured was the owner of a frame building, and, after a long season of extra dry weather, started in to have the building painted, and as a preliminary step began to burn off the old paint by means of a naptha burner, which processes were kept up for four weeks while the dry weather still continued, the court found that the policy was void, saying: "These words imply something of duration, and a casual change of a temporary character would not ordinarily render the policy void under this provision. . . . We are of opinion that the change of condition was sufficiently long continued to be deemed a change in the situation or circumstances affecting the risk" (16).

§ 65. **Increase of risk by tenants.** The mere fact that an increase of risk within the meaning of the policy was made by a tenant of the insured would clearly not violate the policy, unless the latter ordered or knew of this increase (17).

§ 66. **Employment of mechanics.** This clause: "If mechanics be employed . . . for more than fifteen days at any one time" (18) was inserted to limit the possibility of repairs being made of considerable duration, but

(15) Townsend v. Insurance Co., 18 N. Y. 168.
(16) First Congregational Church v. Ins. Co., 158 Mass. 478.
(17) Merriam v. Insurance Co., 21 Pick. (Mass.) 162.
(18) App. E, l. 45.

not enough to amount to an increase of hazard within the principles above discussed. Under this clause, it makes no difference whether the risk was increased or not. The only question is whether the work continues for a longer time than that allowed by the policy (19).

§ 67. **Interest of insured.** A further proviso in the New York Standard policy makes the policy void, "if the interest of the insured be other than sole and unconditional ownership" (20). In other policies, the phrase is "entire, sole, and unconditional ownership", or "sole and absolute ownership". The courts in construing these phrases have not attempted to give them a technical meaning. They have said that the purpose of the clause was to make it sure that the insured should be the person upon whom the loss would fall if the buildings were burned. Thus, if A owned a house which B has in writing agreed to buy, since A can compel B to buy, even though the property should be destroyed by fire, B is clearly the real owner, although the legal title is still in A; and it has been held that, under these circumstances, B can satisfy the requirement as to sole and unconditional ownership (21), while A cannot (22). For the same reason, a mortgagor since the loss would fall on him and not the mortgagee, can satisfy this requirement as to ownership (23); and for the same reason this requirement is not affected by the existence of an outstanding lease nor by an outstanding

(19) Insurance Co. v. Coos, 151 U. S. 452.
(20) App. E, l. 47.
(21) Dupreau v. Insurance Co., 76 Mich. 615.
(22) Insurance Co. v. Huron Co., 31 Mich. 346.
(23) Dolliver v. Insurance Co., 128 Mass. 315.

lien (24). For precisely the converse reasons, the requirement cannot be satisfied by a mortgagee (25) nor a lessee, nor a lienor.

If the ownership is split up among several persons, no one of them can satisfy this requirement. Thus, where property is owned by a husband and wife and a policy is taken out by either alone, it is bad (26). If the insured has only a life interest, this clause is not satisfied (27). So, if the interest is limited in any other way, as when property is given to the insured to hold until a particular date. Following the underlying idea above mentioned, however, of seeing who would be the loser if the property were destroyed, it has been held that the condition of the policy is not broken if the outstanding interest is extremely small, as a one-seventh interest; or if, although the property is held jointly, the insured, because of improvements put on that part of the land which he has insured, would be entitled to have it set off to him separately (28).

§ 68. **Change of interest, title, or possession.** The language of the New York Standard policy is that it is void if "any change other than by the death of the insured takes place in the interest, title, or possession of the subject of insurance" (29). There are two other somewhat similar clauses that are sometimes found in other policies. One of them provides for the voiding of the policy if there

(24) Wooddy v. Insurance Co., 31 Gratt. (Va.) 362.
(25) Waller v. Assurance Co., 10 Fed. 232.
(26) Schroedel v. Insurance Co., 158 Pa. 459.
(27) Collins v. Insurance Co., 44 Minn. 440.
(28) Insurance Co. v. Wigginton, 89 Ky. 330.
(29) App. E, l. 54.

shall be "any alienation, sale, or transfer," and the other form is, "sale, transfer, or change in title or possession." It is now well settled that the first of these two last mentioned clauses has no application, so long as any interest, however slight, remains in the insured. Thus, where an individual so insured takes in a partner (30), or where partners are insured and sell out to one of them (31), this clause is not broken. Neither is it broken where the insured sells his entire interest, but at the same time takes a mortgage back (32). It is also well settled that a transfer by death does not come within this proviso (33).

§ 69. **Change of title.** If the policy provides against "change of title", it is none the less broken although the insured keeps throughout an insurable interest in himself, if in fact he actually parts with his legal title. Thus, a sale by the insured with an immediate mortgage back violates this clause (34). But the legal title must actually be changed. It is not sufficient that there is an agreement to transfer it. Thus, it is well settled that an agreement in writing to sell the property does not constitute a change of title, even though the contract is capable of being specifically enforced (35). So, if the deed by which the property is purported to be conveyed is void, as for usury, there is no change of title within the meaning of this proviso. Whether partnership changes of the kind discussed above violate this clause is a question on which the

(30) Blackwell v. Insurance Co., 48 Ohio St. 533.
(31) Hoffman v. Insurance Co., 32 N. Y. 405.
(32) Hitchcock v. Insurance Co., 26 N. Y. 68.
(33) Pfister v. Gerurg, 122 Ind. 567.
(34) Savage v. Insurance Co., 52 N. Y. 502.
(35) Smith v. Insurance Co., 91 Cal. 323.

courts are not agreed. It is generally held that where one person is insured and then takes in others, there is a change of title. The converse state of affairs in some jurisdictions is held not to be change of title, since no new person is introduced into relation with the company (36). The validity of this distinction is perhaps somewhat doubtful.

§ 70. **Change of interest.** How much the phrase "change of interest" adds to the limitation above discussed is not clear. Some courts have said that this phrase is synonymous with "change of title". One distinction that has been made by some courts is in the case where the insured has made an enforceable agreement to sell his property. This has been said to be a change of interest, although it is not a change of title (37). This, however, has also been denied by other courts.

§ 71. **Mortgage or lien.** It is well settled that a mortgage or lien of any kind is not in violation of any of the clauses above discussed. To prevent the giving of a mortgage, a special clause covering such a transaction is frequently inserted in the policy. For the same reason, a foreclosure or tax sale, where the title is not completely transferred until the expiration of the time for redemption, is not generally held to be within the language above discussed (38).

§ 72. **Keeping or using dangerous articles.** Almost all policies forbid, in one form or another, the keeping or using of specific articles on the premises insured. The

(36) Hathaway v. Insurance Co., 64 Iowa, 229.
(37) Gibb v. Insurance Co., 59 Minn. 267.
(38) Wood v. Insurance Co., 149 N. Y. 382.

New York Standard policy provides that it shall be void "if (any usage or custom of trade or manufacture to the contrary notwithstanding) there be kept, used or allowed on the above described premises" certain specified articles (39). The language of the policies in this regard has been carefully limited by the courts. As to the words "store" or "keep", which are frequently used in this proviso, it is to be noted that the same limitations apply as to the clause relating to the increase of hazard. That is to say, there must be a certain permanency about the transaction to bring it within the proviso. Thus, where the insured took out a policy on his building and the policy forbade the "storing or keeping" of flax, and the building had been previously used for carding flax, and a certain small amount had been inadvertently left in the attic, the court held that this did not violate the requirements of the policy, saying that the language of the policy "in this connection seems to demand a continued occupation of the whole or a part of the premises insured in pursuance of the design for that specific purpose. . . . There is a manifest distinction between a deposit of hazardous goods and a deposit for the purpose of keeping them." A further distinction that has been made between "storing" and "keeping" is that the former means keeping for the purpose of being taken away in substantially the same condition and bulk as that in which it was brought. "Keeping" applies to a retention with no such idea of removal (40). The word "using" carries with it the same idea of continuity or permanency. Some

(39) App. E, l. 61.

(40) Insurance Co. v. Langdon, 6 Wend. (N. Y.) 623.

courts, however, have held that any user, if it substantially increases the hazard, is a violation of the policy (41).

§ 73. **Manufacturing establishments.** There is a further very important qualification of this clause to be noted. It may best be illustrated by a statement of the leading case on this point. A printing establishment took out a policy of insurance upon its "printing and book materials, stock paper and plates," and in the written part of the policy, designating the property insured, were the further words, "privileged for a printing office, bindery, and book store." The policy also obtained a provision substantially like the one under consideration, providing that it should be void if certain hazardous goods were kept or stored on the premises, and among the hazardous goods so mentioned was "camphene". The insured had to keep camphene on the premises for use in connection with the business. After the destruction of the premises by fire, an action was brought against the insurance company, and it set up as a defense the violation of the clause against storing or keeping camphene. The court held that this defense was not available, saying "the underwriters must be deemed to have been acquainted with the business and the materials ordinarily and necessarily used by the trade for prosecuting it. In issuing the policy they must be deemed to have intended to include all such materials in their risk. In construing the policy, it is to be treated as if the article of camphene for the use to which it was in fact applied had been enumerated with the articles covered by the policy. . . . When the insurance

(41) Wheeler v. Insurance Co., 62 N. H. 326.

is directly upon the stock in trade . . . to hold that a general printed prohibition (contained in every policy of insurance) against keeping or using it, unless permission be especially given and endorsed upon the policy, would have the effect to nullify its direct and positive stipulations, would be preposterous. . . . If the article was necessarily and ordinarily used in the business, it is included in the term 'stock' used in the policy, [and] it is as clearly within the risk assumed by the defendant as if written in at length" (42). This doctrine is clearly established and universally followed.

§ 74. **Stocks of merchandise.** The same principle is generally applied to insurance on stores and stocks of merchandie, although the courts are not unanimous on this point (43). The clause in parentheses in the New York Standard policy regarding trade customs has no effect at all, because the effect of insuring a business or a stock in trade is just the same as though the company had in so many words written into the policy a permission to use the things that in the printed part it forbids the using of, and obviously, under these circumstances, the written part of the policy, as being specifically applicable to the case in hand would overcome the language of the printed part of the policy (44).

§ 75. **Households.** Whether the same principle is to be applied to household goods is not so clear. It is arguable that if the company, in that part of the policy which is written in, insures household goods or insures a dwelling

(42) Harper v. Insurance Co., 17 N. Y. 194.
(43) McComber v. Insurance Co., 7 Gray (Mass.) 257.
(44) Faust v. Insurance Co., 91 Wis. 158.

house, that it must be taken to have impliedly consented that there shall be included in the subject matter of the insurance whatever is properly found in a dwelling house, even though among those things are found such articles as are forbidden by the printed part of the policy; and such has been held (45). On the other hand, it may be said that, while it is a matter of business necessity that a printing establishment should have camphene, it is not a matter of necessity but merely of convenience that a household should have gasoline, for example, and that the cases are to be distinguished for that reason. Consequently, it has also been held that a householder keeping prohibited articles was not protected by the mere fact that he had his household goods, as such, insured (46).

The word "allowed", whether used in connection with manufacturing or mercantile establishments or households, adds nothing to the language of the policy. It is construed to mean only "allowed to be kept or used" (47), on the general principle that the court will not make a forfeiture clause any broader than it has to. It is well settled that if the articles specified are kept or used in a permanent way, it is no defense to the insured landlord that this was done by his tenant without his consent (48).

§ 76. **Vacancy and unoccupancy.** The New York Standard provides that it shall be void, if a building insured shall "be or become vacant or unoccupied and so remain for ten days" (49). It must be noted that the

(45) Insurance Co. v. Greene, 16 Tex. Civ. App. 531.
(46) McFarland v. Insurance Co., 46 Minn. 519.
(47) Insurance Co. v. Fischer, 92 Fed. 500.
(48) Insurance Co. v. Norwaysz, 104 Ill. App. 390.
(49) App. E, l. 71.

two words are in the alternative and that they have different meanings. These words have been thus defined by one court in the case of a dwelling house: "The different things that are receptive of the epithets 'vacant' and 'unoccupied' are different in their capability and susceptibility of being filled or occupied. Some cannot have one of those terms applicable to them, without the other at the same time being also applicable. Some, from the nature of the use which goes with the occupation of them, may not be vacant, and yet they will, in any just use of the term as applicable to them, be unoccupied. A dwelling house is chiefly designed for the abode of mankind. For the comfort of the dwellers in it, many kinds of chattel property are gathered in it. So that, in the use of it, it is a place of deposit of things inanimate and a place of resort and tarrying of beings animate. With those animate far away from it, but with those inanimate still in it, it would not be vacant, for it would not be empty and void. And, as a possible case, with all inanimate things taken out, but with those animate still remaining in it, it would not be unoccupied, for it would still be used for shelter and repose" (50).

§ 77. **Same: Permanence of condition.** As with "increase of hazard", and "keeping and using" prohibited articles, the courts have held that there is no violation of the section now under discussion, unless there is a certain degree of permanency about the vacancy or unoccupancy. Mere temporary absence, though for more than ten days, is not a violation of the policy. Thus, in one case, the

(50) Herrman v. Insurance Co., 85 N. Y. 162.

insured and his wife left their home and went to a neighboring city in order that the wife might undergo medical treatment. They were absent for eight months. The furniture however remained in the house, the husband was out there at frequent intervals, and during some of the time slept there. The court held that the house was not vacant or unoccupied within the meaning of the policy (51). So, where the tenant of the insured had gone out of the house, and the insured had moved part of his own furniture in at once and had intended to get in the remainder, but was not yet sleeping in the house, and it was burned during that situation it was held not to be vacant or unoccupied within the meaning of the policy (52). So, where a saw mill was insured, and, because of the breaking of a saw and the water power being low, the mill was not used for over ten days, although all the machinery was there and there was lumber there to be sawed as soon as they could get the machinery in and get sufficient power, it was held that the clause against vacancy or unoccupancy had not been broken (53). So, where an ice house was insured and there was no ice in it during October, the court held that the policy must be construed in the light of the character of the structure insured, and that the clause under consideration had not in that case been violated (54). On the other hand, a mere colorable attempt to use the premises will not be sufficient to keep the policy alive, if the house is in fact abandoned as a

(51) Insurance Co. v. Peyson, 54 Neb. 495.
(52) Shackleton v. Sun Fire Office, 55 Mich. 288.
(53) Whitney v. Insurance Co., 72 N. Y. 117.
(54) Ice Co. v. Insurance Co., 99 Iowa, 193.

home. Thus, where the insured had moved out for six months leaving only a few pieces of furniture in the house and occasionally slept there, the policy was held to be voided (55).

§ 78. **Same: Single buildings or series of buildings.** Another important distinction in connection with this clause turns on whether the property covered by the insurance is insured as a single building, or as a series of separate buildings. If the former is the case, the question of whether this condition is violated is settled by looking at the structure as a whole. In the latter case, each separate building must be judged on its own merits. This distinction is well brought out by two cases. In the one case, the property was insured as "a ten tenement frame block." Eight of the tenements were vacant, but the policy was held good for the reason that the structure as a whole could not be said to be vacant and unoccupied (56). In the other case, a policy was for "eight double house blocks at $187 per block." In that case the policy was held bad as to each of the double houses which were vacant and unoccupied, and not saved as to those by the fact that the others were still in use (57).

§ 79. **Non-user of manufacturing establishments.** This clause is very similar in its nature and character to the clause last examined. The New York Standard policy provides that it shall be void "if the subject of insurance be a manufacturing establishment and . . . it cease

(55) Insurance Co. v. Hamilton, 82 Md. 88.
(56) Harrington v. Insurance Co., 124 Mass. 126.
(57) Insurance Co. v. Tilley, 88 Va. 1024.

to be operated for more than ten consecutive days" (58). The same construction has been put upon this clause. A mere cessation of work, even though continued for more than ten days, will not void the policy if it is only temporary in its nature. Thus where a furniture factory was closed down because of the prevalence of yellow fever, and remained in that condition for more than ten days, the policy was held not to be broken (59). So, where a saw mill was shut down for more than ten days because of the illness of the superintendent, this was held not to be a violation of the clause under consideration (60).

§ 80. **Illegality.** There is one implied condition in fire insurance, as in all, based upon public policy, namely, that the insurance shall not be in furtherance or protection of an illegal act. It is not meant by this statement that the mere fact that one illegal act, for example, takes place in the structure insured violates the policy. Thus, where a building was insured and it was used on one occasion as a gambling place in violation of the statute prohibiting gambling, the policy was held not to be voided for this reason (61). But if the purpose of taking out the policy is primarily the protection of an illegal business, as in a case where insurance is taken out on liquor which is kept for sale in violation of the state statute prohibiting the ownership or sale of intoxicating liquors, the policy will be unenforceable (62). And it would probably be

(58) App. E, l. 42.
(59) Poss v. Assurance Co., 7 Lea (Tenn.) 704.
(60) Ladd v. Insurance Co., 147 N. Y. 478.
(61) Boardman v. Insurance Co., 8 Cush. (Mass.) 583.
(62) Kelly v. Insurance Co., 97 Mass. 288.

held that, even though the policy was originally taken out for a lawful purpose, if in fact the character of the business is changed so that the main purpose of it becomes illegal, the policy would be void under those circumstances.

SECTON 3. FIRE INSURANCE: CONDITIONS APPLICABLE AFTER LOSS.

§ 81. **Language of policy.** It is to be noted that the New York Standard policy does not in so many words make the requirements on the insured after loss conditions of the policy. The New York Standard policy provides (63) that he shall perform certain acts, among these the furnishing of the proofs of loss, within sixty days after the fire. Further down in the policy (64) it provides that the company shall not be liable to action unless these foregoing requirements have been satisfied by the insured. Just what the effect is on the rights of the insured under such a policy, if he fails to furnish the proofs of loss within sixty days, is a matter of dispute. The courts of New York and of some few other states have held that the total effect of the language of the policy is to make the requirements, as to what the insured must do after loss, conditions, on the performance of which, within the time specified by the policy, his right to recover depends, and if he does not so perform them the policy is void (65). Most of the states, however, going on the general principle already referred to, that the court will not make the language of the policy that of forfeiture,

(63) App. E, ll. 142-168.
(64) App. E, ll. 214-218.
(65) Quinlan v. Insurance Co., 133 N. Y. 356.

unless it is perfectly clear that such is the intention of the parties, have held that any failure on the part of the insured to present his proofs within sixty days does not avoid the policy, but simply postpones the right of the insured to bring his action until he has presented his claim; and, inasmuch as by another clause of the policy (66) the insured must bring his action within one year after fire, that this substantially protects the company (67).

§ 82. Immediate notice of loss. The New York Standard policy requires the insured after fire to give "immediate notice of loss to the company" (68). This means simply that the insured must give it notice of the loss, as soon as it is reasonably possible under the circumstances for him to do so. Thus, after the great fire in Chicago in 1871, when all business was in great confusion, it was held that notice given five weeks after the fire was "immediate" under the circumstances (69). In another case, where there was sickness and great difficulty in making up the inventory, it was held that six weeks was not too long. On the other hand, in one case where there was no reason why the insured should not have immediately sent in his notice of loss, it was held that a delay of 48 hours was a violation of this requirement of the policy (70).

§ 83. Proof of loss. The above considerations do not apply to that language of the policy that requires "proof of loss to be furnished within sixty days after the fire"

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(66) App. E, l. 217.
(67) Hall v. Insurance Co., 90 Mich. 403.
(68) App. E, l. 142.
(69) Insurance Co. v. Gould, 80 Ill. 388.
(70) Brown v. Assurance Co., 40 Hun (N. Y.) 101.

(71). This being a definite fixed period must be conformed to by the insured. The sixty days, however, does not begin to run until the fire is out and the ruins sufficiently cooled so that they can be examined (72); and it is enough if the proof of loss be mailed within sixty days, even though it be delivered later (73).

§ 84. **Certificate of loss.** The New York Standard policy provides that the insured shall upon the request of the company "furnish a certificate of the magistrate or notary public . . . living nearest to the place of fire" (74). The courts have held, as to this requirement, that the difference of a few feet would not violate the requirement, where both magistrates lived substantially the same distance from the place of fire. But if the magistrate whose certificate is obtained is substantially farther away, it does not satisfy the requirement (75). Nor is it any excuse that the nearest magistrate refused for any reason to give the certificate (76). Some jurisdictions have held that this requirement is contrary to public policy and have consequently refused to give it any recognition (77).

§ 85. **False swearing.** The New York Standard policy provides that it shall be void, "in case of any fraud or false swearing by the insured touching any matter relating to this insurance or the subject thereof, whether

(71) App. E, l. 148.
(72) Wall Paper Co. v. Insurance Co., 175 N. Y. 226.
(73) Insurance Co. v. Zeitinger, 168 Ill. 286.
(74) App. E, ll. 163-168.
(75) Gilligan v. Insurance Co., 20 Hun (N. Y.) 93.
(76) Johnson v. Insurance Co., 112 Mass. 49.
(77) Insurance Co. v. Norris, 100 Ky. 29.

before or after a loss" (78). This clause is frequently brought in question in connection with overvaluation in making up the proof of loss. It is well settled that mere exaggeration on the part of the insured, however gross, will not avoid the policy, so long as his claims are made in good faith. It has also been held that, even though the valuation is intentionally false, it will not avoid the policy if in fact the actual loss was up to the face of the policy. This seems wrong, as it is contrary to the clear language of the policy, and the weight of authority is against it (79).

SECTION 4. LIFE INSURANCE.

§ 86. **Language of policy.** There is no such large number of conditions in life insurance as are found in fire insurance policies. Certain ones in connection with suicide and insanity will be considered later on (§§ 120-23).

§ 87. **Time of payment of premium.** One clause of the life policy that should be examined at the present time is that requiring the premium to be paid on or before a fixed date. If this date falls on Sunday, the insured has until the following day to make his payment (80). The right of paying the agent of the company, if he can give a receipt properly signed, has been held to be merely a privilege extended to the insured by the company, with the consequent result that it is no excuse for non-payment that the agent did not let the insured know of the premium day (81). And it has also been held, although the

(78) App. E, l. 83.
(79) Dollorf v. Insurance Co., 82 Me. 266.
(80) Hammond v. Insurance Co., 10 Gray (Mass.) 306.
(81) Williams v. Insurance Co., 31 Iowa, 541.

decision is perhaps open to question, that if the local agent dies or cannot for any reason be found, this will not excuse non-payment by the insured on the date specified (82). If payment is made by mail or express it must reach the company upon the day on which it is due, unless the course of business between the company and the insured has authorized the use of the mail or express, in which cases it is enough if the premium is mailed on the premium day, even though it does not reach the company until later, or never reaches the company (83).

§ 88. **Incontestable clause.** Most life insurance policies have a clause providing that the policy shall be incontestable after two years, or some other stated time. This clause waives all defenses by the company, save that of insurable interest. Since this is a requirement imposed by public policy, it cannot be waived no matter how willing the parties are so to do (84). But fraud, or suicide, cannot be used as a defense, if the policy contains such a clause as above given (85). Of course, if the policy reserves the right, as it frequently does, to contest for non-payment of premiums, fraud, or suicide, then the company may do so.

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(82) Bulger v. Insurance Co., 63 Ga. 328.
(83) Kenyon v. Knight Templars, 122 N. Y. 247.
(84) Clement v. Insurance Co., 101 Tenn. 22.
(85) Insurance Co. v. Achterrath, 204 Ill. 549.

CHAPTER IV.

WAIVERS.

Section 1. Principles of Waiver.

§ 89. **Introductory.** Despite the numerous clauses of forfeiture that have been considered in the last chapter, it is a matter of common knowledge that in a large number of cases these conditions are violated to a greater or less degree by the insured, without a forfeiture of the policy following. The principles upon which the preservation of the policy is based, under such circumstances, is a matter that deserves careful consideration.

§ 90. **What is a waiver?** One way in which the policy may be preserved under such circumstances is suggested by the language of the policy itself. Thus, the language of the New York Standard policy, at the beginning of the paragraph containing most of the conditions of forfeiture (1) is that the policy shall be void, "unless otherwise provided by agrement indorsed herein or added hereto." Clearly, if there was an agreement on the policy that the insured could have other insurance, or run his plant later than ten o'clock, or could keep extra-hazardous articles, etc., so doing would not be a cause of forfeiture, for the company would by its consent have waived the right that

(1) App. E, l. 36.

it would otherwise have had to declare the policy void. This principle is of much broader application than merely to formal written waivers. The general principle exists, which is equally applicable in marine, fire, life, and accident insurance, and which is constantly applied by the courts, that, if any representative of the company competent so to do, consents, either expressly or by implication, that the insured may do something inconsistent with the face of the policy, or condones his having so done, the consent of the agent so given will be held to be a waiver of the company's right to enforce a forfeiture on that ground.

§ 91. **Power of agent to waive: Provisions of policies.** Obviously a very important question in this connection is, what agents can thus waive forfeitures of the policy? The New York Standard policy provides (2): "No officer, agent, or other representative of this company shall have power to waive any provision or condition of this policy, except such as by the terms of this policy may be the subject of agreement indorsed hereon or added hereto; and, as to such provisions and conditions, no officer, agent, or representative shall have such power or be deemed or held to have waived such provisions or conditions, unless such waiver, if any, shall be written upon or attached hereto; nor shall any privilege or permission affecting the insurance under this policy exist or be claimed by the insured, unless so written or attached." Similar clauses are found in the life policies. Thus, one policy has this common form: "No person except an executive officer of

(2) App. E, ll. 231-240.

the company, or its secretary at its head office in New York, has power on behalf of the company to make, modify, or alter this contract, to extend the time for paying premiums, and bind the company by making any promise or by accepting any representation or information not contained in the application for this contract."

§ 92. **Such provisions largely ineffective.** As to these provisions, the courts have universally held that they are by no means as sweeping as they sound. The first part of the provision in the New York Standard policy as to who can waive, and as to what conditions can be waived, is treated simply as a statement of fact, that may or may not be true. If as a matter of fact the agent making the waiver in question can be shown to have made similar waivers before then, the court would say that the statement in the policy is not true, and say that in spite of it this agent did in fact have the power to waive, and the present waiver would also be recognized as good and binding upon the company. Thus, in a case involving the same principles in a life insurance policy, the policy provided that if the premium notes were not paid at maturity the policy should be void; and there were other clauses to the effect that agents could not alter the policy or waive forfeitures. The insured gave premium notes on which the agent gave an extension of time, so that they were not paid at maturity. The insured died before they were paid, and the company claimed that the policy was forfeited. The court allowed a recovery, saying:

"That it did authorize its agents to take notes, instead of money, for premiums, is perfectly evident from its con-

stant practice of receiving such notes when taken by them. That it authorized them to grant indulgences on these notes, if the evidence is to be believed, is also apparent from like practice. It acquiesced in and ratified their acts in this behalf. For a long period, it allowed them to give an indulgence of ninety days; after that of sixty; then of thirty days. It is vain to contend that it gave them no authority to do this, when it constantly allowed them to exercise such authority, and always ratified their acts, notwithstanding the language of the written instruments. We think, therefore, that there was no error committed by the court below, in admitting evidence as to the practice of the company in allowing its agents to extend the time for payment of premiums and of notes given for premiums, as indicative of the power given to those agents; nor any error in submitting it to the jury, upon such evidence, to find whether the defendant had or had not authorized its agent to make such extensions; nor in submitting it to them to say whether, if such authority had been given, an extension was made in this case" (3).

§ **93. Same (continued).** The second part of the language quoted from the New York Standard policy relating to the way in which waivers can be made, and similar provisions in other policies, are limited by these considerations: First, it is to be noticed that this limitation is in itself but one clause of the policy, and is therefore waivable just as much as any other clause of the policy; second, this limitation is held to apply only to express waivers on the part of the company, and to have no application at

(3) Insurance Co. v. Norton, 96 U. S. 240.

all to implied waivers (4). On the same principle, a clause which is frequently found in policies, providing that the person making out and answering the application shall be deemed to be the agent of the insured and not of the company, is universally disregarded by the courts as being not in fact true.

§ 94. **Only known causes of forfeiture are waived.** It is obvious that only causes of forfeiture known to the company or its agents, at the time when the act that is relied on by the insured as a waiver of the forfeiture was done by the company, will be held so to be waived. Any doctrine that the company waived all causes of forfeiture, whether known to it or not, would obviously be absurd and unjust. This principle is very well illustrated by a leading case on the point. A life insurance policy provided that it should be void if the premiums were not paid on or before the days mentioned for the payment, and also that it should be void if the insured resided in any part of the United States south of 33° of north latitude, between July 1st and November 1st. It also had the usual clauses that agents could not waive any of the terms of the policy. The insured had been in the habit for some time of paying his premiums after they were due, and these overdue premiums had been regularly accepted by an agent of the company. The insured went to New Orleans, which is below 33° of north latitude, during the month of August. While there he paid his premium to his home agent some time after it was due, the agent not knowing that the insured was in New Orleans. He died shortly thereafter.

(4) Bennett v. Insurance Co., 203 Ill. 439.

In an action on the policy the company set up as a defense, first, that the insured had not paid his premium on time; and, second that he had violated the condition of the policy with regard to residence. The contention of the plaintiff was that the company had waived both these causes of forfeiture. The court decided the case in the following language:

"It was the habit of the agent to give such renewal receipts, whenever the premiums were paid after the time stipulated; and his accounts to the home office showed such subsequent payment. His action in this respect was not questioned by the company; and the premiums were retained by it without any pretense that the policies had ceased to be obligatory for want of punctuality in their payment. The mode of dealing by the agent with persons taking out policies at the local office, his use of renewal receipts, his acceptance of premiums after the day on which they were payable, were all known to the home company, and its retention of the premiums thus received was an approval of his acts. So far, then, as the waiver of the forfeiture incurred for non-payment of the premiums is concerned, it is clear that the company, by its course of dealing, had, notwithstanding the provision of the policy, left the matter to be determined by its local agent, to whom the renewal receipts were intrusted.

"But, so far as the forfeiture arose from the residence of the insured within the prohibited district, the case is different. There is nothing in the acts of the company which goes to show that it ever authorized its agents to waive a forfeiture thus incurred, or that it ever knew of

any residence of the insured within the prohibited district, until informed of his death there. In every case where premiums were received after the day they were payable, the fact that a forfeiture had been incurred was made known to the company from the date of the payment, and the retention of the money constituted a waiver of the forfeiture; but no information of a forfeiture on any other ground was imparted by the date of such payment. The agent receiving the premium, in the case at bar, testified that he knew nothing of the residence of the insured within the prohibited district during the excepted period, and the evidence in conflict with his testimony was slight" (5).

§ 95. **What amounts to a waiver?** It must be noticed further that, as a general thing, to constitute a waiver on the part of the company there must be some action by it or its agents. Mere silence on the part of the company is usually not enough to constitute a waiver. Thus, the insured after a fire sent in his notice of loss which was duly received by the company, but did not send in his proof of loss. When an attempt was made to collect on the policy, he was met by the defence that he had not satisfied the condition as to the proof of loss. He attempted to allege a waiver of that requirement by the company, owing to the fact that they had received the notice of loss and made no requirement on him to send in the proof, but the court held that this condition was unsatisfied, saying: "The policy itself is the most solemn notification possible of the imperative prerequisites of furnishing such

(5) Insurance Co. v. Wolff, 95 U. S. 326.

proofs. It is there stipulated that they must be furnished as soon as possible after the fire, and this stipulation is a standing notice of the requirement. It stands to reason that this notice need not be reiterated by the insurer nor any special attention of the insured called to it. . . . The mere silence of the underwriter or insurer, or his failure to specify the non-production of such preliminary proofs as an objection to payment of the loss, is not sufficient evidence to justify a jury in inferring a waiver of the production'' (6). There are certain exceptions to this rule, where for one reason or another there is an affirmative duty on the part of the insurer to speak. These cases, however, will be considered later on (§ 101-2).

§ 96. **Must the insured be prejudiced?** Whether or not, in order to create a waiver, it is necessary that the insured, as a consequence of what the company has done, should have either acted or failed to act in such a way as to prejudice himself, is a matter on which the courts are not agreed. The general principle of the law, outside of insurance law, seems to be that there must be some prejudice enuring in order that a person may take advantage of an implied waiver, and this also seems to be the general weight of authority in insurance cases as well, although there are decisions to the contrary.

Section 2. Time of Forfeiture and Waiver.

§ 97. **Waiver after breach of policy by the insured.** Coming now to the details of waiver, the cases may be roughly divided into two classes. The first class is where

(6) Insurance Co. v. Oates, 86 Ala. 558.

the insured first violates his policy, and that violation is then waived by some agent of the company. One of the leading cases of this kind was the following: The insured subleased part of his insured building for a business in which use was made of benzine and naphtha, thereby greatly increasing the risk, and this was done without the consent of the company. Later on, however, the local agent of the company, after knowing of this breach by the insured, told the insured that it would be all right if a new stove and zinc under it be put in one of the rooms and if an iron door should be put in another room, and this was done by the insured. Later, the building was burned, and in the action on the policy the company set up the breach of the condition as a defense. The court held that this defense had been waived by the requirements of the agent as to the putting in of the zinc and new door. This is obviously sound. The only ground upon which the agent could have interfered with the management of the building, or made any requirement on the insured, was on the theory that he still had something to do with it, and that could be the case only if the insurance policy was still in force. Consequently, although not said in words, the only inference to be drawn from the entire transaction was that the agent regarded the policy as still being in force on the building (7).

§ 98. **Same: Further illustration.** Another aspect of this same principle is illustrated by the following case: The insured took out further insurance in violation of the terms of his policy. This fact later became known to the

(7) Viele v. Insurance Co., 26 Iowa, 9.

agent of the company. Then a loss took place, and the agent wrote the insured and desired him to send in his proof of loss. This was held to amount to a waiver for very much the same reason as in the preceding case (8). The New York Standard policy seeks to bar this last contingency by its provision that the company "shall not be held to have waived any provision . . . by any . . . proceeding on its part relating to the appraisal or to any examination herein provided for" (9).

§ 99. **Waiver before breach by insured.** The second general class of cases is where the insured has his policy and wishes to do some act in violation of some of the conditions, and he tells the agent of his intention and gets the agent's consent; or where, because of the conduct of the agent of the insurer, the insured is induced to do some act in violation of his policy, under the belief that the agent is willing that he should so act. A very obvious illustration of the first situation is where the insured is required by the agent of the company in which he is insured to take out further insurance and does so. Plainly his taking out the further insurance under these circumstances would not be a violation of the clause forbidding further insurance (10).

The second situation may be illustrated by the following case: The insured had a life insurance policy and for years it had been the custom of the agent to come around and collect from him, notifying him that the premium was due. Under these circumstances, failure by the insured to

(8) Insurance Co. v. Kittle, 39 Mich. 51.
(9) App. E, ll. 189-192.
(10) Cobb v. Insurance Co., 11 Kan. 98.

pay on the date when the premium was due would not forfeit the policy, because of the fact that the previous conduct of the agent had induced him to believe reasonably that he would be notified by the agent that the premium was desired (11).

§ 100. **Waiver contemporaneous with making of policy.** In all the cases which we have hitherto considered, there has been a point of time when the insured had a good and valid policy, and at some time thereafter came the transaction and waiver that formed the subject matter of the case. A somewhat different situation arises in a case like the following: The insured took out a policy containing a clause that, if the building insured was on leased ground, that fact must be specifically expressed on the face of the policy or the policy would be void. The insured at the very moment when he took out the policy told the agent that his building was standing on leased ground, and the agent replied in substance that that would make no difference and that it did not have to be incorporated in the policy. A later attempt to collect on the policy was resisted by the company on the ground that the condition as to leased ground was broken. Now this case is differentiated from all the preceding cases in the fact that, if the contention of the company was sound, there was never a moment when the insured had a good policy, for the reason that the policy was voided as soon as it was issued. As a matter of equity and broad justice, there is of course no substantial difference between this case and the cases which we have been hitherto considering. The insured is

(11) Mayer v. Insurance Co., 38 Iowa, 304.

no less misled by the agent here than in the other cases. There is, however, a rule of law which provides, in substance, that where parties reduce their agreement to writing that writing is supposed to embody all the terms of their contract as they had worked it out at that time. Of course if they later modify the contract, that is a different thing. Led by this parol evidence rule, as it is technically called, some courts, in the situation that we are now considering, have held that the oral agreements of the parties contemporaneous with the issuing of the policy are inadmissible in evidence, and that therefore the parties must stand on the contract as it exists in writing, and that consequently the insured could not recover (12). A majority of the courts, however, have said that the parol evidence rule has no application to this situation, and have allowed the waiver in this case just as in the others (13). This same principle has been applied in the life insurance cases. Thus, in one of the leading life insurance cases on the point, the agent intentionally inserted in the application an answer known to him to be false. The policy provided that it should be void in case of any false answer, but the company was held through the acts of its agent, he knowing the truth, to have waived this proviso (14).

§ 101. **Waiver of conditions applicable after loss.** Hitherto we have considered the waiver only of those conditions which apply before loss. The policy of the courts, where the defense is a breach of a condition which is applicable only after loss, is to lean even more strongly

(12) Batcheller v. Insurance Co., 135 Mass. 449.
(13) Van Schoick v. Insurance Co., 68 N. Y. 434.
(14) Insurance Co. v. Wilkinson, 13 Wall. (U. S.) 222.

against the company than in the preceding cases. The reason for this is obvious. The insured has, as a matter of fact, taken his policy in good faith, lived up to all the conditions regulating the care of his property, and has suffered the loss. Now to refuse him a recovery, because of his failure to comply with some technicality coming into force after the loss, unless the company has really been prejudiced by his failure to comply with this subsequent requirement, would obviously be letting a technicality defeat the ends of substantial justice, and the courts are extremely loath so to do. A common case of this kind is where the insured, after his loss, sends in his proof. This is received by the company and it objects to some items in it as not being clear or satisfactory, and the insured satisfies the further requirement on the part of the company. The company then refuses payment, the insured begins action, and the company sets up as a defense a failure in some other part of the proof to which it had not hitherto directed his attention. It is universally held that the company, by receiving the proof and calling attention to certain defects, thereby waives any other defect (15). Similarly, where the policy provided that there should be arbitration of the amount of loss, after proof of loss has been submitted, if the parties are unable to agree on the amount and the company arbitrates the loss before receipt of the proofs of loss, this is a waiver of the right to demand the proofs (16). Similarly, the right to an award by arbiters is waived by a refusal to arbitrate (17).

(15) Blake v. Insurance Co., 12 Gray (Mass.) 265.
(16) Carroll v. Insurance Co., 72 Cal. 297.
(17) Wainer v. Insurance Co., 153 Mass. 335.

§ 102. **When mere silence is a waiver.** In this class of cases, mere silence on the part of the company may, under certain circumstances, amount to a waiver. Thus, where the policy limits the amount of time within which the insured may file his proof of loss, if the company receives a defective proof, says nothing about it at all, and then, after the time has expired, raises objection, it is held to have lost the right so to do by not notifying the insured within a proper time that the proofs, as he originally sent them in, were unsatisfactory (18).

(18) Insurance Co. v. Cusick, 109 Pa. 157.

CHAPTER V.

LOSSES COVERED BY POLICY.

§ 103. **Introductory.** In general the kind of loss that is covered in marine, or fire, or life insurance, is indicated by the very name of the insurance. Thus, in general, it may be said that marine insurance covers losses on the sea, fire insurance losses by fire, and life and accident insurance death, or injuries of one kind or another to the person. In order, however, to understand somewhat more in detail the rights of the insured under these various forms of policies, it will be necessary to examine more carefully the exact language of the policies.

SECTION 1. MARINE INSURANCE.

§ 104. **Language of policy.** The most important losses provided against in marine insurance are against "those of the seas . . . fires . . . barratry of the master and mariners and all other perils, losses, and misfortunes."

§ 105. **Kinds of losses covered.** In the first place it is to be noticed that there are two kinds of loss in marine insurance: actual and constructive. An actual loss takes place when the subject matter of the insurance, the vessel or cargo or freight, is actually destroyed so that it no longer exists in specie. A constructive loss takes place

when the vessel, for example, still exists as a vessel, but is so situated, because of a peril insured against, that a prudent owner would be justified in abandoning it, or is so badly damaged by a peril insured against that the loss exceeds one-half the value. The same principle applies to the cargo or to the freight. A constructive loss exists with the latter, where either it cannot be earned or to earn it would cost more than it would be worth (1). Under any of the above circumstances, the insured may treat the property as "constructively" lost and "abandon" it. That is to say, he gives notice to the insurance company that he elects to treat it as a total loss. He may then recover on his policy as for a total loss, and the property abandoned goes to the company.

§ 106. **"Perils of the sea"** cover only those losses which result from the unusual and extraordinary action of the elements. The mere ordinary wear and tear on the vessel is natural, and obviously could not fairly be expected to be covered by the insurance. Thus, the gradual depreciation of the machinery, the wearing out of the sails, the chafing and straining of the rigging, are none of them covered by the policy. On the other hand, losses by sudden storms, by shipwrecks, or by any unusual actions of nature resulting in loss or injury are covered. Whether an injury to the vessel was by a "peril of the sea," within the meaning of the policy, in many cases depends upon what are the usual conditions of navigation in that regard. Two cases somewhat similar on the facts will illustrate this difference. In one case, a vessel went into a tide

(1) Bradlie v. Ins. Co., 12 Pet. (U. S.) 378.

harbor and as the tide ebbed lay on the bottom. The beach however was somewhat sloping and the result was that the vessel had a list which finally strained her to such an extent that she was broken. In this case the court held that the damage could not be recovered, since the vessel was put aground purposely, as was intended, and the character of the harbor was such that the grounding and listing in this way were to be expected (2). On the other hand, where in a similar case the vessel entered a tidewater harbor, but, owing to the presence of an unusual swell, she struck ground with violence much greater than common and was injured therefrom, the loss was held to be within the policy (3).

§ 107. **Collision.** Collision is also a peril of the seas within the meaning of the policy, though often covered by a separate provision. It makes no difference whether the collision is brought about by the action of the elements or the negligence of the navigators, for it is a general principle of the law of insurance, applicable not only to marine, but also to fire and life insurance, that the neglect of the person insured is one of the risks that the insurer takes upon himself. But where the loss is due, not primarily to the negligence of the navigators, but to an original defect in the equipment of the vessel, the insurer is not liable (4).

§ 108. **Loss on board vessel.** The mere fact that the loss takes place on board the vessel does not render it a loss by peril of the seas within the meaning of the policy.

(2) Magnus v. Buttemer, 11 C. B. 876.
(3) Fletcher v. Inglis, 2 B. & Ald. 315.
(4) Marine Insurance Co. v. Hamilton, 12 App. Cas. 484.

Thus, in one of the leading cases of this kind the facts were as follows: A steam-boat was at anchor, and an attempt was made to fill the main boiler by means of a donkey engine and pump. The pipe leading from the pump to the boiler had been negligently stopped up, so that when the attempt was made to pump the water the pump was broken through the unusual pressure put upon it. This was held not to be a marine loss (note 4, above).

§ 109. **Barratry.** Barratry includes any wilful misconduct by the captain or sailors of a vessel to the prejudice of the owner of the vessel. Thus, scuttling or burning the vessel, wrongfully disposing of the cargo, breach of port regulations, exposing the vessel to forfeiture, are various illustrations of barratrous conduct. A merely negligent act is not barratrous; but, on the other hand, there need be no specific intent to injure the owner of the vessel. Thus, where the captain, in defiance of the orders of the owners, stowed the cargo on deck instead of under the deck as instructed, and a loss resulted therefrom, this was held to be barratrous within the meaning of the insurance policy (5).

§ 110. **Fires.** The fire losses within the meaning of the marine policy will be sufficiently treated under the section on fire insurance, beginning with § 112, below.

§ 111. **All other perils, losses and misfortunes.** The final general clause in the marine insurance policy, covering all other perils, is not as broad in its scope as might be thought. The courts have construed this to cover only other perils of a nature similar to those already specifi-

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(5) Atkinson v. Insurance Co., 65 N. Y. 531.

cally mentioned in the policy. The Hamilton case mentioned above (note 4) is a good illustration of the limitations put upon this clause.

Section 2. Fire Insurance.

§ 112. **Language of policy.** The fire policy insures the person named in the policy against "all direct loss or damage by fire" (6). A somewhat careful examination of these words is necessary in order to ascertain the exact extent to which the courts have gone in giving a recovery.

§ 113. **What is a fire?** It is to be noted that there may be a burning or combustion without fire. Fire, in the meaning of the insurance policy, is a combustion plus light and heat. Hence, in one case where wool had been soaked in water and then left, until, as a result of the chemical reaction it became extremely hot and presented a charred appearance, but there had been no flame, the loss was held not to be a loss by fire (7). So damage caused merely by lightning, if no fire results from it, is not a loss within the meaning of the policy, since lightning is not fire but an electric phenomenon (8). The New York Standard policy and many of the modern policies specifically put this matter beyond doubt by expressly excepting losses by lightning (9), although there is also a provision in the New York Standard policy providing for covering all those kinds of losses if specifically mentioned (10).

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(6) App. E, l. 4.

(7) Woollen Mills v. Insurance Co., 139 Fed. 637.

(8) Kenniston v. Insurance Co., 14 N. H. 341.

(9) App. E, l. 82.

(10) App. E, l. 88.

§ 114. **"Friendly" and "Hostile" fires.** In the next place, one must distinguish the case where the only fire is one that was intended by the insured, but which incidentally produces certain unintended losses. These losses are not recoverable under a fire insurance policy. The leading case on this point is Austin v. Drewe (11). In that case the insured owned a sugar refinery. Owing to the negligence of his servants, a flue in the drying room was left closed one night, and the result was that in the morning the sugar in that room was found to be ruined by the smoke which had worked out through the mill because of closing this flue. The court held that there could be no recovery, for there was no fire except the fire that they intended to have in the heating plant, and the utmost that could be said was that the fire had done something that they did not intend should be done. A modern case that illustrates the same principle is a case where the insured negligently let the water run out of the pipes in his boiler while the fire was still going, and because of that the boiler was ruined. This loss, for the same reason as before, was held not to be within the policy (12). The principle illustrated by these two cases is that of the so-called "friendly" fire, meaning thereby a fire that is intended. On the other hand, contrast with these two cases the following one. The insured set fire to a lot of papers that he had in his stove, with the intention of burning them up. Owing to the intense heat from the papers burning in the stove, the soot in the chimney caught fire and damaged

(11) 6 Taunton, 436.
(12) American Towing Co. v. Insurance Co., 74 Md. 25.

the inside of the chimney. This loss was held to be within the policy (13). The distinction between the two groups of cases is obvious. In the latter case the fire as originally started was a friendly fire, and if there had been no further combustion than that in the stove, the fact that unintended losses resulted therefrom would not have given a recovery, but the friendly fire, when it set fire to the soot in the chimney, then became a "hostile" or unintended fire, and then of course of the kind covered by the insurance.

§ 115. **Fires set by third persons.** It is obvious that any fire set by a third person, although it may be intended by him, is, as regards the insured, a hostile fire, and of course there can be a recovery for any damage caused thereby. It is equally clear, on the other hand, that under no circumstances can the insured recover for a fire purposely set by himself. In this latter connection, however, one must bear in mind the principle mentioned in connection with marine insurance, that mere negligence upon the part of the insured, no matter how extreme, will not bar a recovery by him for any fire loss resulting therefrom, provided, of course, that the negligence is not so great that it may fairly be inferred that the burning was in reality intended. Thus, where the insured attempted to smoke wasps out of a hay barn by lighting a wisp of hay and thrusting it into the dry timbers of the hay barn, in close proximity to the hay, it was held that, although his negligence was extreme, since there was no evidence of bad

(13) Way v. Insurance Co., 166 Mass. 67.

faith, he was not barred from recovering on the policy (14).

§ 116. **Losses that are recoverable.** Once there is a hostile fire, the insurer is responsible for all the consequences thereof: first, which follow directly from the fire without any other intervening cause; and second, which, although they did not follow directly from the fire, are such natural consequences of it that they may fairly be regarded as being within the contemplation of the parties to the contract, as losses intended to be covered thereby (15).

§ 117. **Direct losses.** Illustrations of the first kind of losses are damages to the property insured from charring, although the property has not been actually burned; and damages by smoke or cinders are of course on the same footing. So, where a match was accidentally dropped in a barrel of gunpowder, which exploded and wrecked the insured building, the company was held liable, not only for the loss caused by the actual fire, but also for the losses resulting from the explosion, since the explosion was itself a fire and the immediate cause of all the subsequent damage (16). Many policies now contain a clause that the company is not to be liable for losses caused by explosions. Where the policy has this clause, and there is a fire which in turn causes an explosion, the company is liable only for so much of the damage as is caused by the fire. Where the situation is reversed, and there is an explosion which in turn causes a fire, the company is not

(14) Johnson v. Insurance Co., 4 Allen (Mass.) 388.
(15) App. E, l. 4.
(16) Scripture v. Insurance Co., 10 Cush. (Mass.) 356.

liable either for the loss traceable directly to the explosion, or for that caused by the fire, since the real cause of the whole loss is the original explosion (17). The New York Standard policy, however, would seem to cover the fire loss following the explosion (18).

In connection with this first group of losses, it should be noted that it makes no difference how remote the damage may be, if it can be traced by an unbroken chain of causation to the fire. Thus, in one case, an electric light plant was insured against losses by fire. A fire occurred in the wire tower. The tower and its contents were very slightly injured, but this small fire in the wire tower caused a short circuit, and, as a result of this short circuit, the machinery in another distant part of the building was badly damaged. The court held that the damage to this machinery was recoverable under the fire policy. The court said: "When it is said that the cause to be sought is the direct and proximate cause, it is not meant that the cause or agency which is nearest in time or place to the result is necessarily to be chosen. The active efficient cause which sets in motion a train of events which brings about the result, without the intervention of any force started and working actively from a new and independent source, is the direct and proximate cause referred to in the policy" (19).

§ 118. Indirect losses. Turning now to the second group of cases that are covered by the fire policy, a very

(17) Insurance Co. v. Tweed, 7 Wall. 44.

(18) App. E, l. 81.

(19) Lynn Gas. Co. v. Insurance Co., 158 Mass. 570.

common illustration is the loss caused by water in extinguishing the fire. The immediate cause of the loss is of course the action of the firemen in turning the water on the premises. Since, however, their action is traceable as a matter of common sense to the fire, the loss occasioned thereby is a natural, although not an immediate, result of the fire, and is held to be within the terms of the policy (20). Similarly, the damage to goods caused by removing them, to get them out of the way of a threatened fire, is within the policy, and it is enough if it was a reasonable thing to do to remove them, even though it can be shown that in fact they would not have burned if left where they were (21). The same rule holds where goods are stolen by thieves during the process of removal to a place of safety (22). Another kind of indirect loss that the company has been held liable for is illustrated by the following case: The insured had a wooden warehouse within that part of the city where wooden warehouses could no longer be erected. It was burned. The insurance company offered to show that the structure merely as such was not worth over $900. But to put up a warehouse on the site of the one burned would, because of the municipal regulations forbidding wooden ones, cost about $5,000. The court held that the latter amount was the measure of the loss that the insured had suffered, and that the company was obliged to pay the larger amount so far as it was

(20) Davis v. Insurance Co., 115 Mich. 382.

(21) White v. Insurance Co., 57 Me. 91.

(22) Tilton v. Insurance Co., 1 Bosw. (N. Y.) 367. This kind of loss is excepted by the New York standard policy. App. E, l. 78.

covered by the policy (23). A further illustration of indirect loss within the policy is the case where buildings are torn down or blown up to stop the further spread of a large conflagration. The destruction of the buildings thus torn down has also been held to be a fire loss within the meaning of the policy (24). This kind of loss is excepted by the New York Standard policy, which releases the company from liability for loss "caused directly or indirectly by invasion, insurrection, riot, . . . military or usurped power, or by order of any civil authority" (25).

SECTION 3. LIFE INSURANCE.

§ 119. **Language of policy.** The language of the life insurance policy varies somewhat from that of the marine and fire policies. There is no standard form of life policy, but the general provision is in substance that the insurance company will pay the amount specified to the person named in the policy, upon satisfactory proof of the death of the person whose life is insured. Hence, making a rough analogy to marine and fire insurance, we may say that it is the death of the insured that is covered by the policy. As in the case of marine and fire policies, this language has been the subject of considerable interpretation by the courts.

§ 120. **What deaths are not covered by the policy: Execution, suicide, death in crime.** Not all deaths are cov-

(23) Brady v. Insurance Co., 11 Mich. 425. This kind of loss is excepted by the New York standard policy. App. E, l. 95.

(24) Insurance Co. v. Corlies, 21 Wend. (N. Y.) 367.

(25) App. E, l. 75.

ered by a life insurance policy. It is clearly established that when the insured has been executed as a felon, it is contrary to public policy to allow a recovery (26). The same principle has been held in a number of jurisdictions to prevail where the insured deliberately commits suicide (27). The reason is very much the same. As the court said in the case last cited, it would be clearly contrary to public policy, if A said to B, "If you will commit suicide I will pay your estate $1,000," to let B's estate recover on such a contract. And the principle, although not so obvious, is the same when a recovery is allowed on an insurance contract under similar circumstances. The reason is not that the parties may not have intended to cover that kind of a loss, but that the public policy of the community, regardless of their intent, refuses to sanction any such contract or to recognize any rights as created thereby. The public policy of refusing collection where the insured takes out the policy with the very purpose of committing suicide is clear, and it would seem that it should make no difference whether the policy is payable to his "executors, administrators, or assigns" or to some third person as beneficiary. The reasoning of the Ritter case is broad enough to cover both kinds of cases.

§ 121. **Same (continued).** Where the policy is taken out in good faith but the insured later on commits suicide, the courts in general allow a recovery where the policy is payable to some third person as beneficiary. This has been rested upon the ground that the beneficiary has a

(26) Burt v. Insurance Co., 187 U. S. 362.
(27) Ritter v. Insurance Co., 169 U. S. 139.

vested interest, independent of the relation between the insured and the insurance company, and that the beneficiary therefore recovers in his own right and not merely as the representative of the deceased (28). For converse reasons, the courts have refused a recovery on the same facts where the policy was made payable to the estate of the deceased. In many policies at the present time there is a clause which provides that there shall be no recovery if the insured shall be executed for a crime or commits suicide. This clause of course settles the matter, and under such circumstances there can be no recovery either by the representative of the deceased or by the beneficiary. Another similar clause is frequently found, which provides that there shall be no recovery where the death took place while the insured was engaged in a violation of the law. Under such circumstances, a recovery was refused where the insured had been justifiably killed in self-defense by a person whom he had attacked (29).

§ 122. **Suicide by insane persons.** The principles which we have been considering above and the clause prohibiting recovery in the event of suicide apply only to suicide while the insured is sane. Courts have recognized three possible aspects of insane suicide, not covered by the preceding considerations. These classes are: First, the case where the insured commits suicide not knowing or understanding the physical consequences of what he is doing; second, where the insured commits suicide understanding that the taking of the poison or the discharging of the

(28) Seiler v. Insurance Co., 105 Iowa, 87.
(29) Murray v. Insurance Co., 96 N. Y. 614.

revolver will end his life, but being so diseased mentally that he has no control over his acts and is driven by an irresistible impulse to take his own life; third, where the insured understands that what he is doing will result in taking his own life and is not compelled thereto by an irresistible impulse, but he is at the same time so diseased and abnormal mentally that he does not really appreciate or understand the moral quality and character of the act that he is performing.

It is now well settled in all three of these cases that there can be a recovery upon the policy although it specifically excepts death by suicide (30).

§ 123. **Clauses covering insane suicide.** To prevent the results indicated in the last subsection, most insurance policies now bar a recovery in case of suicide "sane or insane." Some courts, even under these circumstances, have said that where the insured does not know what he is doing, or is driven to take his own life by an irresistible impulse, that is, where the suicide falls in either class one or class two above mentioned, it cannot be said to be the act of the insured in any real sense of the term, and consequently does not fall within the exception of the policy (31). The general rule, however, is that this clause in the policy will prevent a recovery where the insured takes his own life, regardless of the particular form of insanity from which he may be suffering (32).

§ 124. **Negligent death.** As might be expected from

(30) Insurance Co. v. Terry, 15 Wall. (U. S.) 580.
(31) Insurance Co. v. Daviess, 87 Ky. 541.
(32) Bigelow v. Insurance Co., 93 U. S. 284.

the analogies of marine and fire insurance, the fact that the negligence of the insured contributes to bring about his death will not bar his recovery, so long as the negligence is not so extreme as to lead to the conclusion that the death was intentional.

SECTION 4. ACCIDENT INSURANCE.

§ 125. **Language of policy.** The usual form of accident insurance policy protects the insured "against the effect of bodily injury" caused "by external violent and accidental means." The desire on the part of the courts to give the largest possible reasonable construction to these words, and to make as broad as possible the classes of case that they have thought ought to be included within the policy, has led to interpretations being put on these words that are very far from usual or what one would naturally put upon them and they require a somewhat careful examination.

§ 126. **External.** By an *external* means is meant a means or cause coming from outside the body, even though the injury it produces is within the body. Thus, cases of death or injury caused by accidentally inhaling gas (33), or by drowning (34), are deaths by external means, although the way the death is brought about in each case is of course by the action upon the lungs. Accident policies sometimes except death or injury caused by inhaling gas. This exception has been construed by the courts to apply only to a conscious or intentional inhaling of gas,

(33) Paul v. Insurance Co., 112 N. Y. 472.
(34) The Indemnity Co. v. Dorgan, 58 Fed. 945.

as for an operation or suicide, and not to cover cases where it is accidentally taken in during the night and breathed while asleep, or in some other way taken by mistake (35). The same principle has been applied where the policy excepted death resulting from poison, the insured being allowed to recover where the poison was taken by mistake (36). Policies also sometimes have a clause that there shall be no recovery, unless there shall be some external mark of injury. Here it is held that any mark, however slight, is sufficient. The proviso has no application at all in cases of death, since the existence of death itself is a sufficient manifestation of the fact that injury has been received.

§ 127. **Violent.** A *violent* means of injury is any kind of physical force, however slight. Thus, where the insured brought rotten meat in contact with his face and died from a malignant pustule in the meat, this was held to be a death by violent means (37). So, where the insured injured his leg in stooping over to pick up a marble, that exertion was held to be a sufficient violence to come within the terms of the policy (38); and so a sting from a wasp (39). Whether the force must be physical, as stated above, is a point on which the cases are divided. In one case a runaway horse came extremely close to the insured, who was not touched but was badly frightened

(35) Insurance Co. v. Dunlap, 160 Ill. 642.
(36) McGlother v. Insurance Co., 89 Fed. 685.
(37) Higgins v. Campbell [1904], 1 K. B. 828.
(38) Hamlyn v. Insurance Co. [1893], 1 Q. B. 750.
(39) Amberg v. Accident Ass., 101 Ky. 303.

and died from the fright within a short time thereafter, and a recovery was allowed on the policy (40).

§ 128. **Accidental means.** *Accidental means* or cause has been defined as a cause occurring unexpectedly or unforeseeably and without the design or intent of the person injured. Thus, if the insured is intentionally injured by a third person, as where the insured was hanged by a mob, it is, so far as he is concerned, accidental, and recovery may be had on the policy (41). So, if there is no intention at all on the part of the insured, as in the case where he committed suicide while insane (42), this latter of course being subject to the same qualifications as discussed in the preceding section on life insurance.

§ 129. **Same: Accidental distinguished from accidental means.** It is necessary to distinguish carefully between an accidental death and a death by accidental means. Only the latter is covered by the language of the policy. This distinction is well illustrated by a Scottish case. In this case the insured, who had just risen from his bed and was in the act of putting on his stockings, died suddenly. The cause of his death was pressure on the heart, resulting from the fact that his colon had fallen out of place and become folded. The court refused to allow a recovery, using the following language: "A person may do certain acts the result of which may produce unforeseen consequences and may produce what is commonly called accidental death; but the means are exactly

(40) McGlinchey v. Casualty Co., 80 Me. 251.
(41) Insurance Co. v. Johnson, 72 Miss. 333.
(42) Insurance Co. v. Crandal, 120 U. S. 527.

what the man intended to use and did use. . . . The means were not accidental but the result might be accidental. . . . The man was just doing what he meant to do and apparently an unexpected result happened—the man's death" (43). The same distinction has been made in several American cases. Thus, where the insured was exercising with Indian clubs, swinging the clubs in the ordinary way and just as he intended to do, and while so swinging there occurred the unexpected rupture of a blood vessel, it was held that the cause of the injury was not an accident and not within the terms of the policy (44). So, where the insured knew himself to be very ill with consumption and shut a window that stuck, and the result was a hemorrhage from which he bled to death, the death was held not to be a death by accidental means, if he did physically just what he tried to do, and the only difference was that it produced a result that he did not anticipate or intend (45). On the other hand, in a leading case in this country, the insured jumped off a high platform and landed on the ground in such a way as to cause injuries, for which he attempted to recover on his accident insurance policy. The court instructed the jury that, if he jumped and alighted as he intended to do, nothing unexpected or involuntary occuring affecting his body during the time from the moment he jumped until after he alighted, then he could not recover on the policy, even though an injury followed which he did not expect; but if, on the other hand, while jumping or alighting, there

(43) Clidero v. Insurance Co., 29 Scot. Law Rep. 303.
(44) McCarthy v. Insurance Co., 8 Ins. L. J. 208.
(45) Feder v. Travelling Assoc., 107 Iowa, 538.

occurred from any cause any unforeseen or involuntary turn or strain of the body which brought about the alleged injury, in that case the injury was brought about by accidental means and a recovery could be had upon the policy (46). The Hamlyn case mentioned before (note 38) is another illustration of the same principle.

§ 130. **Accident followed by disease.** It is not necessary in order to bring the injury within the meaning of the policy that it should have been directly produced by external means. It is enough if the injury can be traced to an accident as an effective cause of it, even though it is traced through the intervening agency of a disease, which in turn was brought about by the accident. Thus, where the insured bought a new pair of shoes, which caused an abrasion on his toe through which blood poison set in, which resulted in death, this was held to be a death that was covered by the policy. The fact that the immediate cause of it was the blood poisoning was held to be immaterial, since the blood poisoning was a disease due to the abrasion which was produced by accidental, violent, and external means (47). In another case the insured slept on his hand, which rested on the rail at the head of his bed, for so long that the periostium of some of the bones in his hand was injured. This in turn caused periostitis. He sued on an accident insurance policy for this injury, and the court allowed a recovery on the same principle as in the preceding case (48). Both of these cases also offer

(46) Accident Association v. Barry, 131 U. S. 100.
(47) Travelers Assn. v. Smith, 85 Fed. 401.
(48) Insurance Co. v. Fitzgerald, 165 Ind. 317.

valuable illustrations of the extent to which the courts have gone in construing the words "external" and "violent." Another instance of recovery, where the immediate cause of the death or injury is a disease, but which in turn is traceable to an accident, is a case of pneumonia and death, resulting from a weakness caused by a fall (49); and also death caused by a rupture, in turn traceable to a fall.

§ 131. **Disease followed by accident.** On the other hand, the fact that the insured already had a disease which weakened him so that he suffered from an accident under circumstances where the normal man would not have been affected, will not prevent his recovery (50). This is perfectly sound on principle, and follows exactly the analogy of the explosion cases in fire insurance (§ 117, above). Many insurance policies now have clauses providing that there shall be no recovery for a death caused in whole or in part by disease. This limitation is strictly construed by the courts, and the fact that the disease was present will not bar the recovery if it can be said that the effective cause of the death was after all the accident.

§ 132. **Kinds of injuries.** Three kinds of injuries may be covered by an accident policy, namely, death, total disability, and loss of members. Death is not covered by the phrase "total disability." To include the former it must be specifically mentioned (51).

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(49) Isitt v. Assurance Co., 22 Q. B. Div. 504.
(50) Tennant v. Insurance Co., 31 Fed. 322.
(51) Rosenberry v. Casualty Co., 14 Ind. App. 625.

§ 133. **Total disability.** By total disability, either temporary or permanent, is meant a state of affairs where the insured is substantially prevented from carrying on his business, although he may be in such a condition that he can still attend to some small details thereof. Thus, it has been held that a physician, who is so badly injured that he is confined to his bed, is totally disabled within the meaning of the policy, although he has while in bed prescribed for some few patients (52). So a laborer who could work for a few moments at a time, but not sustainedly or so as to command any wages, was held to be totally disabled (53). When the insured, however, is engaged in two businesses, and insured as being so engaged, he must prove a total disability in both; as in one case where he was insured as a leather cutter and merchant, and had his hand hurt so that he could not cut leather but could still sell, he was held not to be totally disabled within the meaning of the policy (54). On the converse of the same principle, the mere fact that the insured cannot attend to all of the details of his business does not amount to total disability. Thus, where the insured was a lawyer who had sprained his wrist so that he was prevented from writing freely, but otherwise could attend to his work, he was held not to be totally disabled (55).

§ 134. **Loss of limbs.** With reference to the loss of particular parts of the body, it is not necessary that they should be actually severed from the body. It is sufficient

(52) Wolcott v. Insurance Co., 55 Hun (N. Y.) 98.
(53) Grand Lodge v. Orrell, 206 Ill. 208.
(54) Ford v. Insurance Co., 148 Mass. 153.
(55) Assurance Co. v. Millard, 43 Ill. App. 148.

if they are rendered useless. Thus, where the insured was injured by a bullet wound in the back, so that both his legs were paralyzed, he was allowed to recover as for a loss of both legs (56). Some policies require "loss by severance" in order to entitle the insured to recover. This has been construed as applying only to the *method* of loss, so that if part of the hand is cut off in such a way as to render the rest of the hand useless, this was held to be a total loss by severance of the hand (57).

(56) Sheanon v. Insurance Co., 77 Wis. 618.
(57) Sneck v. Insurance Co., 34 N. Y. Supp. 545.

CHAPTER VI.

RECOVERY AND SUBROGATION.

§ 135. **Introductory.** As has already been said, the general principle of insurance may be said to be indemnity only, not that the insured should profit to any degree out of the loss or transaction against which he has been insured. This principle of indemnity only is particularly applicable to marine and fire insurance. For reasons which will be pointed out later on, it is not applicable to life and accident insurance.

SECTION 1. MARINE INSURANCE.

§ 136. **Total loss.** Where a total loss takes place in marine insurance, no question can arise as to the amount of recovery. The insured necessarily recovers up to the full face of the policy, providing of course that that amount does not exceed the amount of his actual loss. In a valued (1) policy the amount of the recovery is definitely settled by the face of the policy. All that the insured need prove is that the loss took place. In the open (1) policy the insured must prove the amount of his loss. If the article insured is the vessel, the amount of the loss is the value of the vessel at the beginning of the risk. If it is the cargo that is insured, the amount of loss is measured

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(1) § 3, above.

by the actual cost of the cargo when loaded; or, if that cannot be ascertained, by the actual cost of the cargo ashore plus what it would cost to load it. If it is the freight that is insured, the amount of recovery equals the gross charges for the freight with no deduction for the cost of transportation. The same principles for estimating loss apply as well in the case of a constructive loss (2) assuming that the facts are sufficient to justify an abandonment on the part of the insured.

§ 137. **Partial loss.** In the case of a partial loss, marine insurance has one doctrine that is peculiar to it, and that is the doctrine of co-insurance between the insurer and the insured, the general principle being that the insurer contributes to the partial loss only in the ratio that the amount of insurance bears to the total value. Thus, suppose a vessel is worth $50,000, is insured for $30,000, and there is a $5,000 loss. This is of course a loss of one-tenth of the actual value of the vessel, and the insurer pays the same proportion of that loss that $30,000 bears to $50,000, that is to say, three-fifths of $5,000. In other words, with marine insurance, if the insured wants to get full indemnity for partial loss, it is necessary to have the property insured for its full value. This principle applies to insurance of vessel, or cargo, or freight.

Section 2. Fire Insurance.

§ 138. **Open policy: Total loss.** Where the owner of property has it totally destroyed by fire, the general principle is that if the policy is open, the value of the property

(2) § 105, above.

at the time of the fire determines the amount of recovery, it of course under no circumstances exceeding the face of the policy. On this general principle, however, various applications and modifications have been made according to the nature of the property insured.

§ 139. **Same: Staple articles.** If the property insured is personal property that has a regularly established market value the case presents no difficulty. Obviously, under those circumstances, what the insured is out is represented by the market value of the property insured, at the time and place of loss. This rule is well settled. It has been applied for example in the case of the loss of groceries, dry-goods, lumber, bagging, and tobacco (3).

§ 140. **Same: Articles owned by manufacturer.** It is immaterial in this class of cases that the insured also manufactures the goods that have been destroyed. He can nevertheless recover the market value of them. This point was well discussed in a recent Michigan case. In that case the insured was a manufacturer of lumber and owned his own forest and mill. The policy which was in the New York Standard form, provided, among other things, that the amount of recovery should "in no event exceed what it would then cost the insured to repair or replace the same." The court said: "We think the word 'then' is significant and must be given weight in determining the true intent and meaning of the contract. If defendant's theory of construction be adopted, the word 'then' must

(3) Huckins v. Insurance Co., 31 N. H. 238; Fowler v. Insurance Co., 74 N. C. 89; Assurance Co. v. Studebaker, 124 Ind. 176; Insurance Co. v. Cannon, 19 Tex. Civ. App. 305; Boyd v. Insurance Co., 111 N. C. 372.

be dropped out and the contract construed as intending to give to the insurance company the benefit of the time it would take the insured to replace it or reproduce it. . . Clearly it [the contract] means just what it says, 'what it would *then* cost the insured to replace it' and not what it would cost the insured to cut from his own stumpage, manufacture lumber at his own mill, and replace after the delay of cutting, also sawing, piling in the yards, etc. We are unable to agree with the learned counsel for the defendant that the contract is to be construed any differently in this case than though the plaintiff had no stumpage of his own and no mill by which he could manufacture lumber. It means that the plaintiff had the right, on the date of the fire to recover from the defendant such an amount of money as it would cost to replace the lumber, or, in other words, the market value of the lumber at the date of the fire" (4).

§ 141. **Same: Realty.** With realty the value obviously cannot be the market value. In the first place the market value of the building is always necessarily so involved with the value of the land that it is impossible to separate them and say how much each is worth alone. In the second place, to adopt the market value as the measure of recovery would be plainly unfair in many cases, and this unfairness might work either against the insured or against the insurance company. Thus, suppose a lonely farm house was insured, substantial and perfectly satisfactory as a home, but so situated that no one would want to buy it. Clearly the insured ought not to be confined to

(4) Mitchell v. Insurance Co., 92 Mich. 594.

a mere nominal sum in his recovery, but such would be the result if the market value were taken as the measure of damage. On the other hand, suppose the insured owns an extremely cheap tenement house in an extremely desirable locality, so that he is deriving large rents from it. In such a case, the market value of that tenement might be very much more than what it would cost to replace it, and yet plainly, under those circumstances, the company ought not to be held for the larger amount. For these and other reasons, the rule has been generally established, with regard to real estate, that the insured recovers the value of the property at the time and place of the fire. The estimation of this must necessarily rest in the sound judgment of the jury. A helpful test is to ascertain what it would cost to replace the building destroyed, less the depreciation of the building at the time of the fire from wear and tear (5).

§ 142. **Same: Non-staple articles.** In the case of chattels having no market value the situation is analogous to that of real estate. Take for example household furnishings. They are clearly worth more to the owner than what a second-hand dealer would give for them, and the jury must bear that fact in mind in determining the amount of recovery (6). The same principle has been applied to the case of a valuable thorough-bred stallion.

§ 143. **Valued policies.** In the case of a valued policy (7), if there is a total loss the owner does not need to

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(5) Insurance Co. v. Taylor, 14 Colo. 499.

(6) Fire Office v. Ayerst, 37 Neb. 184.

(7) § 3, above.

prove the value of the property, but recovers the amount that has been agreed upon in the policy as being the value of the property insured. The advantage of this for the insured is that it renders his recovery safe and certain, just as soon as he establishes the fact that the fire took place. The advantages and simplicity of this situation have appealed so strongly to many state legislatures that they have passed acts providing, that, in the case of insurance of realty where there is a total loss, all policies shall be deemed to be valued policies. It is to be noted that this applies only to insurance of realty, and only in the case of a total loss. A loss is deemed to be total when the property is so far destroyed that a reasonable, prudent owner would prefer to tear down rather than attempt to repair what is left standing (8). These valued policy statutes have a far-reaching incidental effect in annulling several of the most common clauses found in insurance policies. It has been held that the purpose of the statute is so far a matter of public policy that the benefit of it cannot be waived by the parties, no matter how clear the intention may be to have the policy not valued. From this it follows that an agreement that the company shall pay the "actual value" of the property destroyed is of no effect (9). The same result follows as to the clause providing that the amount of the loss shall be arbitrated. It has also been held that a clause giving the company the right to rebuild is nullified by the valued policy statute, for the reason that, if rebuilding would cost

(8) Insurance Co. v. McIntyre, 90 Tex. 170.

(9) Reilly v. Insurance Co., 43 Wis. 449; Insurance Co. v. Leslie, 47 Ohio St. 409.

less than the value of the property at the time of the fire, that is an indirect evasion of the statute; and, if the rebuilding would cost as much as the value of the property at the time of the fire, then there is no reason for rebuilding rather than paying (10).

§ 144. **Partial loss.** In partial loss the principle of co-insurance as it exists in marine insurance, was decided at an early date to have no application to fire insurance. The insured recovers in full for his partial loss, regardless of the ratio between the amount of insurance and the value of the property, until he has recovered up to the whole amount covered by the policy; provided, of course, as always, that that does not exceed the amount of the loss (11). Policies some times contain a clause providing that the company is not to be liable for more than a stated per centage (frequently two-thirds) of the loss, the effect of such a clause being to make the parties co-insurers in that same proportion.

§ 145. **General ownership subject to outstanding interests.** Thus far, on the question of the amount of recovery, we have been considering cases where only one person is interested in the property insured. There may, however, well be cases in which the insured is not the only one with an interest in the property. These cases may be either of two kinds. The interest of the insured, although not the only one, may be indefinite so far as the exact value is concerned, or it may be definite, and these of course require separate examination. Suppose A owns

(10) Insurance Co. v. Levy, 12 Tex. Civ. App. 45.
(11) Nicolet v. Insurance Co., 3 La. 366.

a building and B has a mechanic's lien on that building for $3000. There are now two interests in the building. Suppose A takes out a policy and the building burns. How much can A recover? Clearly he is still the owner of the building and just as clearly the ultimate loss as between himself and B will fall on A. So, irrespective of the extent of B's lien, A can still recover the full value of the building insured (12). The same principle applies if B, instead of being a lienholder, is a mortgagee, and for the same reason. So, if A, after mortgaging to B, gives a second mortgage to C, A is still the owner of the building —the one on whom the loss will ultimately fall—and consequently he can still recover up to the full value of the building. So, even, it has been held, if A's equity of redemption has been sold, but he still has a period within which to redeem from the purchaser at the sale (13). Another case that illustrates the same principle is this: Suppose B agrees in writing with A to buy A's house and lot. As between A and B, B is now the real owner of the property. Even though the house is burned, A can still tender him a deed and compel him to pay the full value. A's only interest in the premises is for the unpaid purchase price, if any. It will be seen, therefore, that this situation is in its essence like the situation of mortgagor and mortgagee, B now occupying substantially the position of mortgagor and A that of mortgagee. It is well settled that under these circumstances B may insure for the full value of the property and recover in case of loss (14).

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(12) Foley v. Insurance Co., 152 N. Y. 131.

(13) Strong v. Insurance Co., 10 Pick. (Mass.) 40.

(14) Insurance Co. v. Tyler, 16 Wend. (N. Y.) 385.

§ 146. Limited interests not definitely measurable. A somewhat different group of cases to which the same principle has been applied is this: Suppose A is a widow, who has a dower interest for her life in the property in question, and then the property is to go to X, her child. Under these circumstances A is for the present the owner of the property. If the house as a structure is worth $10,000, it cannot be said with certainty that, if it is destroyed, anything less than $10,000 will indemnify A; and, if her policy is for that amount, it is generally held that she can recover in full (15). This case illustrates very clearly the fundamental doctrine of insurance law, that, what is insured, is by the terms of the policy, the property and not the interest of the insured. The language of the policy (16) is "against all direct loss or damage by fire . . . *to the following described property.*" The position that the insured takes, and in which he has been sustained by the courts, is that the language of his policy is clear; that he has satisfied the requirements of an insurable interest (17) and that, because of the indefinite extent of his interest, it cannot be said that he is getting more than indemnity in getting the full value of the property insured. This doctrine was perhaps even more strikingly illustrated in the following case: A, the insured, was the owner of a building which stood on leased ground, and his lease of the ground had only a short time to run. The building was destroyed by fire, and A was allowed to recover the full value of the building. The court

(15) Merrett v. Insurance Co., 42 Iowa, 11.
(16) App. E, l. 4.
(17) §§ 9-11, above.

rested its decision upon the grounds above mentioned (18).

§ 147. **Limited interests definitely measurable: Liens.** Let us pass now to the second kind of limited interests, namely those which can be exactly measured. Take the reverse of the case already considered. Suppose A owns a house worth $10,000 and B has a mechanic's lien or a mortgage upon it for $3000. As has already been said, A clearly has an insurable interest as owner and can recover as such. Clearly B also has an insurable interest (19). Suppose B does insure and the house is totally destroyed, but the land, which is covered also by the mortgage or the lien, is alone enough to satisfy that mortgage or lien, or suppose that A is personally good for the amount of B's claim. Can B, under these circumstances, recover from the company when it may be said that in one sense he has suffered no loss? It is well established that he can, and the reason is the fundamental doctrine already referred to, that what is insured is the property, and not the interest of the insured or the solvency of the mortgagor. And the same principle applies where there is only a partial destruction of the house, providing the amount of damage equals $3000 (20). The same principle is illustrated on facts very different from those last considered. Suppose A owns a house and lot worth $10,000. He gives a first mortgage to B for $7,000 and a second mortgage to C for $5000. C takes out a policy for $5000, the property

(18) Laurent v. Insurance Co., 1 Hall (N. Y.) 41.
(19) §§ 9-11, above.
(20) Insurance Co. v. Insurance Co., 55 N. Y. 343.

is totally destroyed, and A is insolvent. C can recover his $5000 from the company, although it is clear that he could not get it out of the property or out of A. Of course this principle that what is insured is property and not the interest, and that consequently the insured may recover with reference to the injury to the property and not with reference to the injury to his interest, is limited by the equally fundamental proposition that in no case can the insured recover more than what will indemnify him. Thus, in the case last given, if B, the firt mortgagee for $7000, had taken out a policy for $8000, and the property had been totally destroyed, it is clear that B could not recover more than the $7000, which would fully indemnify him; and it would be useless for him to argue that the total value of the property destroyed was greater than that. In other words, the principle with reference to lienors, mortgagees, and other persons with definitely limited interests, is well stated in a leading United States case as follows: "One who has a mechanic's lien on the property, by virtue of a contract with the owner, has an equal insurable interest, limited only by the value of the property and the amount of his claim" (21).

§ 148. **Same: Vendor and vendee.** As a matter of strict logic one would expect, following the principles already considered, that, in the case of vendor and vendee, the vendor could recover on a policy no more than the unpaid balance of his claim against the vendee, and this regardless of the amount for which his policy was issued. In fact, the very decided weight of authority in this coun-

(21) Insurance Co. v. Stinson, 103 U. S. 25.

try seems to be that the vendor may recover for the full value of the property insured, and, after deducting enough to satisfy himself, he must turn over the balance to the vendee to aid in indemnifying him (22). The reason for this doctrine will be explained later (§ 154). The same principle is applied in some jurisdictions in the case of insurance by a life tenant (23). The same principle has also been applied to a warehouseman taking out insurance on property stored with him. He may recover the full amount and hold the sum so recovered as trustee for the various depositors (24).

§ 149. **Co-insurance.** Suppose A owned property worth $15,000, and he took out three policies in three different companies, each for $5000, and then suffered a $3000 loss. He can clearly recover his $3000 from any one of the three companies that he chooses. He cannot recover more, because of the principle of indemnity only. The company from which he recovers will then proceed against the other companies to compel them to pay their respective proportion of the loss, so that it will ultimately rest on all three. To do away with this circuitous method of adjusting the respective rights of the parties, the policies today almost always contain a clause providing that the company shall not be liable for a greater proportion of any loss, than the amount insured by that policy shall bear to the whole amount of insurance taken out on the property (25). Where all policies cover the same prop-

(22) Insurance Co. v. Updegraff, 21 Pa. 513.
(23) Welch v. Assurance Co., 151 Pa. 607.
(24) Waters v. Insurance Co., 5 E. & B. 870.
(25) App. E, ll. 197-200.

erty, or where the loss exceeds the total amount carried on all the policies, no difficulty arises. However, very considerable difficulty arises in a case like this: Suppose the insured is a retail store keeper. He has one policy on the building and contents, one policy on the contents in general, and one policy on dry goods alone; and there is a partial loss on the dry goods alone. There is much difficulty as a matter of mathematics in adjusting the loss under these circumstances so as to comply with the proportionate clause of the policy, and the courts have worked out the case in various ways. Questions of this kind, however, are generally settled by adjusters for the various companies between themselves (26).

§ 150. **Subrogation to tort rights.** The doctrine of subrogation is a very important one in both marine and fire insurance. It may be most easily explained by an illustration. Suppose A owns a house worth $10,000, insured for its full value. Suppose the house is burned by the negligent act of X, a third person. Clearly A can say to the insurance company: "My property has been destroyed by fire; you insured me against that kind of loss, and that loss has occurred; your obligation now is to pay." And clearly the company must pay. Suppose, now, after A has collected from the company, he sues X for the wrong done in wrongfully burning the house. Clearly A can obtain judgment against X for $10,000, and, if X is solvent, recover that amount from him. If that is done, the total effect of the transaction is that A has lost a $10,000 house,

(26) See at length on this point, Griswold's Fire Underwriters' Text Book (1st ed.), pp. 630-685, 706-746.

but has collected $20,000, so that in the long run, so far from the destruction of the house being a loss to him, it has been an actual profit. It is equally clear that, just as soon as A recovers the $10,000 from the insurance company, the one who was really damaged by the wrongful act of X was not A, who has now been made whole, but the insurance company, who was obliged to make him whole. Further than this, it would obviously be bad public policy to allow A to keep the whole $20,000, for, if that were the law, it would be for his advantage not to safeguard his property but to neglect it. For these reasons, an English case over a hundred and fifty years ago (27) laid down the law that, when the company pays under these circumstances, it is entitled to stand in the shoes of the insured and to pursue against the wrong doer all rights that the insured acquired against him by the act which has brought about the loss. Or, as the doctrine is technically put, the insurance company, on payment of the amount of the policy, is *subrogated* to the rights of the insured. This is also well-established law in this country.

§ 151. **Same: Independent of order of procedure.** So salutary a rule as the foregoing should not and does not depend on the order of procedure. The insured may, if he wishes, proceed against the company, and then it, after paying, proceed against the tort feasor; or, the insured may, if he pleases, proceed against the tort feasor, in which case he can not proceed against the company. For the same reason, if the insured releases his claim against the

(27) Randal v. Cockran, 1 Ves. Sr. 98.

tort feasor, so that the company on paying the policy and attempting to enforce the claim against the tort feasor would be met by the release, then the insured loses his right of recovery against the company to the extent that he has prejudiced it by his release of the tort feasor (28).

Another and different illustration of this same principle of subrogation is the following case: A was a farmer who took out an insurance policy on his hay, which was burned by a railroad. A collected his claim from the railroad and then presented his claim on the policy to the insurance company. The insurance company paid him and then, attempting to sue the railroad, found that A had already collected from it. Under these circumstances, the insurance company was allowed to recover from A the amount that had been paid him on the policy (29). On the other hand, if the wrong doer settles with the insured, knowing at the time that the latter has already collected from the insurance company so that the company is already in equity the owner of the claim for damages, the release acquired by the tort feasor from the insured will be no defense to an action by the company; for the reason that, at the time the tort feasor bought his release from the insured, he knew that the insured had no right to the claim (30).

Policies nowadays very frequently provide in so many words that the company shall be subrogated to the rights of the insured against the wrong doer, and also frequently further require the insured to assign to the company any

(28) Insurance Co. v. Storrow, 5 Paige (N. Y.) 285.

(29) Insurance Co. v. Weller, 98 Iowa, 731.

(30) Hart v. Railroad Co., 13 Metc. (Mass.) 99.

claim that he may have against the wrong doer arising out of the act causing the injury to the property insured (31). This language would seem to add little or nothing to the substantial rights of the company.

§ 152. Subrogation against carriers. The general principles of subrogation apply as well against common carriers as elsewhere. Hence, where the insured ships goods by a railroad and they are burned, so that the railroad becomes liable therefor, and he then collects from the insurance company, the company can in turn sue the railroad (32). To meet this situation, the railroad companies at an early date began to insert this clause in the bills of lading: "The railroad shall have the benefit of any insurance that may be taken out upon the goods covered by this bill of lading." Now it must be noticed that, while, as already said, the insurance company is subrogated to the rights that the insured has, it gets no larger rights than he had. Consequently, if at the very moment of the wrong complained of, the right of the insured was limited by a contract between himself and the wrong doer, the insurance company on payment can get only this limited right. Hence, in this case, if the company after paying the insured tries to sue the railroad company, it finds itself met by the fact that the insured has put himself by contract in such a position that, if he had collected from the company, he could not sue the railroad, and consequently the company can get no larger right. This principle is perfectly well established as a matter of decision,

(31) App. E, l. 207.
(32) Hall v. Railroad Co., 13 Wall. (U. S.) 367.

and it is immaterial whether the policy was taken out before the bill of lading (33) or vice versa (34). In other words, the effect of this clause in the bill of lading is to make the insurance taken out by the insured operate; first, for his benefit; and secondly for the benefit of the railroad, so that the loss falls ultimately on the shoulders of the insurance company, and it has no method of shifting it upon the railroad.

To meet this situation various clauses have in turn been adopted by the insurance companies. Thus, in one case, A, the shipper, took out an insurance policy which provided as follows: "In case of any agreement or act whereby any right of recovery is released or lost, which would on payment of loss by this company belong to it, except for such agreement or act, or in case this insurance is made for the carrier of the property, the company shall not be bound to pay the loss" (35). In another case a policy had this clause: "Warranted that this insurance shall not enure to the benefit of any carrier" (36). The result of course of these clauses is to prevent the insured from recovering against the insurance company, if his bill of lading contains a clause such as that noted above, since, by the very terms of the policy, the validity of the policy is conditioned on there being no such agreement. On the other hand, of course, the insured still has his right of recovery against the carrier (37).

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(33) Inman v. Railway Co., 129 U. S. 128.
(34) Insurance Co. v. Transportation Co., 117 U. S. 312.
(35) Fayerweather v. Insurance Co., 118 N. Y. 324.
(36) Insurance Co. v. Easton, 73 Tex. 167.
(37) Inman v. Railway Co., 129 U. S. 128.

§ 153. **Subrogation to contract rights.** Suppose A owns a house worth $10,000 and gives a mortgage to B for $7000, and B takes out an insurance policy as mortgagee. Suppose then the property is totally destroyed and B recovers the $7000 from the insurance company. Ought the company, on payment of B's claim to be subrogated to B's mortgage right as against A? There is clearly a difference between this case and the case which we have just been considering. In that case there was a direct connection between the loss suffered by the company in payment of the claim and the wrongful act of the tort feasor, against whom they ask the subrogation right. Here there is no such relation. The argument against allowing subrogation in this case was well stated in a Massachusetts case in the middle of the last century, as follows:

"But it is said, and in this certainly lies the strength of the argument, that it would be inequitable for the mortgagee first to recover a total loss from the underwriters, and afterwards to recover the full amount of his debt from the mortgagor, to his own use. It would be, as it is said, to receive a double satisfaction. This is plausible, and requires consideration; let us examine it. Is it a double satisfaction for the same thing, the same debt or duty?

"The case supposed is this: A man makes a loan of money, and takes a bond and mortgage for security. Say the loan is for ten years. He gets insurance on his own interest, as mortgagee. At the expiration of seven years the buildings are burnt down; he claims and recovers a loss to the amount insured, being equal to the greater part of his

debt. He afterwards receives the amount of his debt from the mortgagor, and discharges his mortgage. Has he received a double satisfaction for one and the same debt?

"He may surely recover of the mortgagor, because he is his debtor and on good consideration has contracted to pay. The money received from the underwriters was not a payment of his debt; there was no privity between the mortgagor and the underwriters; he had not contracted with them to pay it for him, on any contingency; he had paid them nothing for so doing. They did not pay because the mortgagor owed it; but because they had bound themselves, in the event which has happened, to pay a certain sum to the mortgagee.

"But the mortgagee, when he claims of the underwriters, does not claim the same debt. He claims a sum of money due to him upon a distinct and independent contract, upon a consideration, paid by himself, that upon a certain event, to wit, the burning of a particular house, they will pay him a sum of money expressed. Taking the risk or remoteness of the contingency into consideration (in other words, the computed chances of loss), the premium paid and the sum to be received are intended to be, and in theory of law are, precisely equivalent. He then pays the whole consideration, for a contract made without fraud or imposition; the terms are equal, and precisely understood by both parties. It is in no sense the same debt. It is another and distinct debt, arising on a distinct contract, made with another party, upon a separate and distinct consideration paid by himself. The argument opposed to this

view seems to assume that it would be inequitable, because the creditor seems to be getting a large sum for a very small one. This may be true of any insurance. A man gets $1000 insured for $5 for one year, and the building is burnt within the year; he gets $1000 for $5. This is because, by experience and computation, it is found that the chances are only one in two hundred that the house will be burnt in any one year, and the premium is equal to the chance of loss. But suppose—for in order to test a principle we may put a strong case—suppose the debt has been running for twenty years, and the premium is at five per cent, the creditor may pay a sum equal to the whole debt, in premiums and yet never receive a dollar of it from either of the other parties. Not from the underwriters, for the contingency has not happened, and there has been no loss by fire; nor from the debtor, because, not having authorized the insurance at his expense, he is not liable for the premiums paid.

"What, then, is there inequitable, on the part of the mortgagee, towards either party, in holding both sums? They are both due upon valid contracts with him, made upon adequate considerations paid by himself. There is nothing inequitable to the debtor, for he pays no more than he originally received, in money loaned; nor to the unterwriter, for he has only paid upon a risk voluntarily taken, for which he was paid by the mortgagee a full and satisfactory equivalent" (38).

§ 154. **Same: Practical considerations.** While it is impossible as a matter of logic to deny the force and cor-

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(38) King v. Insurance Co., 7 Cush. (Mass.) 1.

rectness of this reasoning there are nevertheless strong reasons of policy against it. If the mortgagee can recover on his policy contract from the insurance company, anl also on his mortgage contract from the mortgagor, it is obvious that he has an extremely strong incentive to cause the property to be burned, and no incentive the other way. These reasons have led most courts in this country to apply the doctrine of subrogation to this class of cases, and to hold that, where the mortgagee has recovered from the insurance company, the company is then subrogated to his rights as against the mortgagor (39). This doctrine has since been declared by statute, even in Massachusetts. However, this result is not entirely satisfactory. The company collects premiums on the theory that it is to stand the total loss, and, regardless of any question of subrogation, it retains those premiums. Consequently, if the mortgagor is solvent, the ultimate loss falls entirely upon him, and the insurance company has the premiums collected by it as a clear profit. The unfairness of this has induced many courts, in the analogous case of vendor and vendee, to refuse to apply the doctrine of subrogation, and to hold that, where the vendor has insurance and collects the face of the policy, he holds any sum, beyond what may be necessary to reimburse him for the balance due from the vendee, as trustee for the benefit of the vendee. The consequence of this doctrine of course is that the loss falls ultimately upon the company, which has been collecting premiums as payment for taking just that chance

(39) Kernochan v. Insurance Co., 5 Duer (N. Y.) 1.

(40). Of course, if the vendor states in his policy that it is to cover both the interests of himself and the vendee, there is not the slightest reason for objection to this doctrine, and this would be equally true in the case of insurance by the mortgagee, if he intends in fact to cover the interest of the mortgagor (41). In cases, however, where there is no such intention on the part of the vendor, to allow him under those circumstances to recover more than enough to indemnify him and then as to the balance to hold him as trustee for the vendee, is a pure fiction on the part of the courts, indulged in by them to accomplish what seems more nearly substantial justice.

Section 3. Life and Accident Insurance.

§ 155. **Not contracts of indemnity.** Life and accident insurance differ materially in one respect from fire and marine insurance. They are not contracts of indemnity. The courts have given as a reason for this difference, although it is perhaps not a very satisfactory one, that it is impossible to indemnify for the loss of life or limb, and that the only purpose of the policy is to bind the insurer to pay a certain amount upon the happening of the contingency provided for. Be the reason what it may, the law is well settled that these policies are merely agreements to pay on the happening of the contingency, and that no question can be raised as to the amount of the damage actually suffered by the insured. This is strikingly illustrated in the case where a creditor takes out,

(40) Insurance Co. v. Updegraff, 21 Pa. 513. See also, § 148, above.
(41) Insurance Co. v. Race, 142 Ill. 338.

as he may (42), an insurance policy on the life of his debtor, the debt is paid, and the former debtor then dies. It is generally held that the creditor can still recover the full amount of the policy (43). Some courts, however, hold in this kind of a case, that the creditor can retain only sufficient to reimburse him and any balance goes to the estate of the deceased (44). If the premium in these latter cases has been paid by the debtor, or has been charged up against him, so that it is really his policy, the result reached by the last mentioned courts would seem sound. Otherwise the former view seems preferable.

§ 156. **Doctrine of subrogation inapplicable.** With both life and accident insurance it necessarily follows, from the principle that they are not contracts of indemnity that there can be no question of double recovery and hence, in the lack of stipulations to the contrary in the policy, or of fraud, the insured may recover from all the companies insuring him. From the same general principles, it also follows that the doctrine of subrogation has no place in these branches of insurance law.

(42) § 12, above.
(43) Amick v. Butler, 111 Ind. 578.
(44) Tate v. Building Assn., 97 Va. 74.

BANKS, BANKING, AND TRUST COMPANIES

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CHAPTER I

THE BUSINESS OF BANKING

§ 1. **What is meant by banking.** Banking is a business, and any person, natural or artificial, who habitually conducts a business the principal features of which are the transaction of some or all of the incidents of banking is properly designated a banker, but a single or even several isolated transactions precisely similar to those which make up the daily items of a banking business will not constitute one a banker. For example, one of the ordinary transactions of a bank is to loan money, taking the borrower's note for its repayment. Individuals habitually make loans of money and take precisely similar

paper. The most important part of a bank's business is borrowing, but many people habitually borrow. Many persons may, and most business men occasionally do, accept deposits of money agreeing to hold them to the order of the depositors, but the bank deposit is peculiar. In legal effect it is a loan (1). Many men buy or sell notes. Hotels are obliged to receive deposits of money or articles for safe keeping. All these are ordinary things with banks. What then occasions the name Banking and entitles or compels the treatment of the person to be treated as a banker?

In plain words it is as we shall see the making of all of these the habitual business at an established place of business, which makes a bank and constitutes banking (2).

§ 2. **Same: The different kinds of banks.** Before examining these subjects in detail it may aid the understanding to point out the various kinds of banks.

A private bank is one conducted by an individual or partnership.

A state bank is one conducted by a state or by a corporation under a state charter.

A national bank is always a corporation and all national banks operate under the same charter, the same law, and the same rules (2a) and regulations. These are all instrumentalities of the United States by means of

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(1) Marine Bank v. Fulton Bank, 2 Wall. 252; Straus v. Bank, 122 N. Y 382.

(2) American Loan Assn. v. Levy, 33 La. Ann. 1203. See Auten v. U. S. Nat. Bank, 174 U. S. 125; Wyman v. Wallace, 201 U. S. 230.

(2a) State law as such is not allowed to govern the operation or business of National banks. Yates v. Jones Nat. Bank, 206 U. S. 158.

which the constitutional power to borrow money and regulate the value thereof is in part exercised.

§ 3. **Same: Sources of their power.** The three kinds of banks above enumerated are all alike subject to regulations, but each derives its title or authority from a different source. The private banker operates under the common law right to contract, except so far as constitutional laws restrain or regulate his business. The state banks derive authority from the state. The national banks are the creation of the national government and while they exercise many of the same powers exercised by the others they possess other important special privileges, franchises, and exemptions.

§ 4. **Trust companies.** A trust company properly so called is quite a different thing though they do commonly carry on some of the ordinary features of banking. This is easily understood when we remember that much of the business of banking can be done without special authority, as will be explained further on.

§ 5. **Banks of issue.** Formerly private banks and state banks were in the habit of issuing promises to pay the bearer of a bill the sum indicated. They were called "bills of credit" (3), and passed from hand to hand as money; but the national tax of ten per cent on these destroyed the practice (4).

§ 5a. **Savings banks.** A savings bank is, strictly speaking, not a commercial bank, for the pure savings bank receives deposits to be invested for the benefit of the

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(3) Briscoe v. Bank of Kentucky, 11 Pet. 257.

(4) Veazie Bank v. Fenno, 8 Wall. 533.

depositors. A savings bank has neither circulation, checks, drafts, certificates of deposit, or exchange. It is a trustee and not a bank in strict legal parlance. Where a so-called savings bank has capital and is conducted for profit, permitting its depositors to check out, although it is done upon a pass-book, which performs a double office of a certificate of deposit and its return, as a check or draft, the institution must be termed a bank (5).

§ 6. **Nature of banking business.** The ordinary business of banking is conducted almost, if not entirely, by the use of commercial paper as evidence of each transaction. The most common forms of these are (besides ordinary negotiable paper in general use) commercial paper or contracts peculiarly associated with banking, namely, certificates of deposit, checks, cashier's checks, certified checks, bank drafts, pass-books, and bank-books, which, when duly and lawfully issued pass current as money. Banking is, therefore, in its peculiar incidents, a department of the law-merchant, subdivision contracts. By whom conducted, whether by a private individual, partnership, or firm, is a minor incident. It does not change its nature by reason of the person by whom it is conducted, whether the person be an individual, a partnership or a corporation.

Banking has always been regarded as a common law right; that is of common right, subject, of course, to regulation by law upon the same principle as other public businesses, for the business is one so intimately associated

(5) Oulton v. German Sav. Soc., 17 Wall. 109; Louisiana v. Louisiana Sav. Co., 12 La. 572; McCaskell v. Savings Bank, 60 Conn. 310.

with the security of the public credit that it is everywhere regarded as a public business, or as it is technically expressed publici juris and this is not inconsistent with the proposition that ordinary banking is of common right (6).

§ 7. **Definition of a bank.** A bank is an appellation indicating both the place of business and the character of the business. A banker has been defined as "one who keeps a place for the traffic in money; who there receives it from others, and keeps it with his own, using the whole fund as his own, or remits it at request to other places; who repays it at the will and call of his customer; who furnishes money to others on the discount of their obligations, or on securities brought by them; and who buys and sells bills of exchange. To these is sometimes added the issuing of his notes to pass as money, when allowed by law to do so" (7). The peculiarities of the business which distinguish it from other business consist not so much in the elemental transactions as in the manner of their mingling. Attempts at definition have not been particularly happy in producing a definition not subject to some criticism as a definition, e. g., the definition quoted above, leaves wholly out of view the paramount idea of banking as hereinafter mentioned. Likewise, the enumeration of the things which may be done in the course of conducting a banking business and which also may be done apart from it, does not aid us in the least to under-

(6) Freund, Police Power, sec. 400-1; Meadowcroft v. Peo, 163 Ill. 56; State v. Hastings, 12 Wis. 47.

(7) People v. Doty, 80 N. Y. 225.

stand what is meant by banking; that is, does not bring out the characteristic features which cause a business to be "banking" as distinguished from a trust company, or a loaning company, or a savings bank, or a note broker, or other mercantile business. Banking is a business and is not predicable of a single transaction or of an occasional casual transaction similar to banking transactions but incident to trade and commerce.

§ 8. **Same: Federal revenue law.** The statutory definition in the Federal Revenue law brings out the first essential idea involved in defining banking, namely, "having a place of business where credits are opened by the deposit or collection of money or currency, subject to be paid or remitted upon draft, check, or order, or where money is advanced, or loaned, on stocks, bonds, bullion, bills of exchange, or promissory notes," [or where such are received for discount or sale] (8).

§ 9. **Deposits are property of bank.** The fundamental feature of real banking consists in receiving deposits upon the contract implied from the custom of merchants that the money becomes the property of the bank, while the bank agrees that it will at any time repay the money on demand on the order of the depositor. This has been a long-established universal doctrine (9). Other incidents may and usually do accompany the fundamental one, but they are, in truth, incidental and not essential to the creation of a bank.

(8) Warren v. Shook, 91 U. S. 704.

(9) Marine Bank v. Fulton Bank, Note 1, above. See Am. Loan Assn. v. Levy, Note 2, above; Bank v. Hughes, 17 Wend. 94; Cragie v. Hadley, 99 N. Y. 131.

§ 10. **Relation of bank with a depositor is that of debtor and creditor.** The legal contract resulting from the simple acts daily taking place in thousands of banks is almost never expressed in any formal manner but the law gives it a uniform character and affixes definite rights and obligations. The following from a recent case (10) states the universal law of the commercial world.

"The general transaction between the bank and a customer in the way of deposits to a customer's credit, and drawing against the account by the customer, constitute the relation of creditor and debtor. As is said by Mr. Justice Davis, in delivering the opinion of the court in National Bank of the Republic v. Millard, 10 Wall. 152, 19 L. ed. 897, in speaking of this relationship (page 155, L. ed. p. 899):

" 'It is an important part of the business of banking to receive deposits; but when they are received, unless there are stipulations to the contrary, they belong to the bank, become part of its general funds, and can be loaned by it as other moneys. The banker is accountable for the deposits which he receives as a debtor, and he agrees to discharge these debts by honoring the checks which the depositor shall, from time to time, draw on him. The contract between the parties is purely a legal one, and has nothing of the nature of a trust in it. This subject was fully discussed by Lords Cottenham, Brougham, Lyndhurst, and Campbell in the House of Lords in the case of Foley v. Hill, 2 H. L. Cas. 28, and they all concurred in the opinion that the relation between a banker

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(10) Burton v. United States, 196 U. S. 283.

and customer, who pays money into the bank, or to whose credit money is placed there, is the ordinary relation of debtor and creditor, and does not partake of a fiduciary character, and the great weight of American authorities is to the same effect.'

"When a check is taken to a bank, and the bank receives it and places the amount to the credit of a customer, the relation of creditor and debtor between them subsists, and it is not that of principal and agent. . . .

"The case of Cragie v. Hadley, 99 N. Y. 131, 52 Am. Rep. 9, 1 N. E. 537, contains a statement of the rule as follows, per Andrews, Chief Judge:

" 'The general doctrine that upon a deposit made by a customer, in a bank, in the ordinary course of business, of money, or of drafts or checks received and credited as money, the title to the money, or to the drafts or checks, is immediately vested in, and becomes the property of, the bank, is not open to question. Commercial Bank v. Hughes, 17 Wend. 94; Metropolitan Nat. Bank v. Loyd, 90 N. Y. 530. The transaction, in legal effect, is a transfer of the money, or drafts, or checks, as the case may be, by the customer to the bank, upon an implied contract on the part of the latter to repay the amount of the deposit upon the checks of the depositor. The bank acquires title to the money, drafts, or checks on an implied agreement to pay an equivalent consideration when called upon by the depositor in the usual course of business.' "

The transaction of general deposit is in legal effect a borrowing by the bank and a loan by the customer (11),

(11) Note 1, above.

but there seems to be some reluctance to state this broadly.

§ 11. **Bank is not a trustee for deposits.** It is sometimes said that the relation is one of trust and confidence, but there is no other or further obligation on the banker than his promise to repay. He is not obliged to hold money, and in practice does not. He has unlimited discretion in reference to its investment, and is not obliged, in the absence of statute, to keep on hand money or security to pay his depositors. In the last analysis the banking business rests on confidence in the integrity and discretion of the banker.

§ 12. **Same: Criminal statutes.** The frequent failure of bankers has led to statutes regulating the business and fixing criminal penalties for the more common forms of fraud practiced by bankers against customers.

It is a crime in many states, and a fraud everywhere, for a banker, knowing himself to be insolvent, to accept deposits from persons ignorant of the situation; and if a failure follows quickly, under some circumstances equity will treat the deposit as a trust ex maleficio and allow the owner to reclaim the fund on the ground that an assignee or receiver takes only the owner's equities (12).

§ 13. **Deposits classified.** The word "deposit" was originally an apt word to indicate the nature of transactions which constituted the business of banks, viz.: the receipt and safe keeping of special deposits of plate or

(12) St. L. & S. F. Ry. Co. v. Johnson, 133 U. S. 566; Wasson v. Hawkins, 59 Fed. Rep. 233; Peo. v. St. Nicholas Bank, 28 N. Y. Sup. 407; cf. Ober Sons Co. v. Cochran, 118 Ga. 396; 98 Am. St. 118.

money or paper or any other thing where it was the intention and understanding of both parties that the identical thing should be returned (13). Such a deposit is to all intents and purposes a bailment (14). It has become a subordinate feature of the banking business, such deposits being now made the principal subject of the safety deposit business (15).

The various and varied transactions between bankers and customers, which have distinctive features of such definiteness as to impart a different character to the transactions and different legal consequences, are so constantly recurring in the banking business that they have given rise to a classification dependent upon the different consequences which, by law, attach to them.

Classified according to effect, deposits are: first, those where the title does not pass; second, such as pass the title from the depositor to the banker and leave him a debtor; in other words, mere loans upon demand (16).

This classification does not indicate the characteristic features, the presence or absence of which has the effect of changing title; it is, therefore, of little value as a classification. It is not strictly accurate, for in the first instance supposed the title does not always remain in the depositor.

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(13) Morse on Banks, sec. 102 e. 183.

(14) Foster v. Essex Bank, 17 Mass. 479; Pattison v. Syracuse Nat. Bank, 80 N. Y. 82; First National Bk. v. Graham, 100 U. S. 699; Oulton v. German Sav. Soc., 17 Wall. 109-123.

(15) Indeed it has been made the subject of serious question whether a corporation with banking power had implied power to receive special deposits. Foster v. Essex Bank; Pattison v. Syracuse Nat. Bk., Note 14, above.

(16) Marine Bank v. Fulton Bank, Note 1, above; Pattison v. Syracuse Nat. Bank, Note 14, above.

Logical legal classification consists in bringing into view the characteristic features of the transactions; thus formerly all banks received packages, boxes or chests with the understanding, express or implied, to keep and have at all times the specific thing ready for redelivery. Later there arose the custom of establishing places where credits might be exchanged. This necessitated the receiving of deposits which the banker might treat as his own and pay out on the orders of his customers. In time, and by custom, the legal effect of the transaction was to make the money deposited, or the proceeds of the paper discounted, the money of the banker. By this means he accumulated his general deposit fund.

The convenience of business brought about still another transaction which consisted of receiving money or choses for some specific purpose other than redelivery, and not to be made a part of the general deposit fund. This is the specific deposit. It is frequently spoken of in opinions as though it were a special deposit, but it is distinguishable by the fact that the preservation of the identity of the thing is not essential, and that the banker has some active duty other than that of a mere custodian, and, therefore, it becomes a trust in the nature of a bailment. In special and specific deposits the title does not pass to the bank. In special deposits it does not pass from the depositor, but in specific deposits title may pass immediately or conditionally to the beneficiary, for whose benefit the deposit is made (17).

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(17) Crandall v. Woodhouse, 197 Ill. 104; Englar v. Offutt, 7 Md. 78; First Nat. Bank v. Hummel, 14 Colo. 259.

With these characteristic elements in view, definition may be attempted.

§ 14. **What is a general deposit?** The appellation deposit effectually conceals the real nature of the transaction. It is a loan by the depositor, a borrowing by the bank under an agreement, express or implied, to pay upon demand or upon the written order of a customer. The legal effect is that the banker becomes the debtor of the customer, the owner of the money, and there is no trust relationship between the parties. The banker is not a bailee or custodian. A deposit without a qualifying agreement or business habit is presumed to be a general deposit (18).

§ 15. **What is a specific deposit?** A specific deposit is one where money or securities are delivered to a bank for some specified or particular purpose and not for entry on the general account. There is an active duty to be performed by the bank in reference to the money, which constitutes the banker a trustee. Title does not pass to the banker, who remains a trustee, though the title may pass to the beneficiary for whose benefit the deposit is made. This species of deposit is often confused with the special deposit, but there is the distinction that by contemplation of the parties the integrity and identity of the thing delivered need not be preserved, but may be transformed and transferred according to the contract of deposit (19). The importance of this distinction will appear more

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(18) Morse on Banks, sec. 186; Association v. Jacobs, 141 Ill. 261; St. Louis & C. Ry. v. Johnson, 133 U. S. 577.

(19) Morse on Banks, secs. 185, 206; Crandall v. Woodhouse, Note 17, above.

clearly in connection with the treatment of the equitable doctrine of tracing trust funds, we being here concerned only with the creation of such a specific fund (20). See Vol. VII, Art. 3, §§ 91-94.

§ 16. **Same: Illustration.** In Cutler v. Am. Ex. Bank (21) the plaintiffs explained to the officers of the defendant bank that they wished to transmit money to their agent, Hall, at Leadville, and deposited money with the bank on its giving them a letter of credit to the bank of Leadville as follows: "Your account is credited this day $500., received from Cutler, Hall & Co., for use of J. S. Hall." The Leadville bank failed before receiving the money, indebted to the New York bank, which claimed that the deposit was general, and, having been placed to the credit of the Leadville bank, became the money of the Leadville bank, and consequently subject to the claim of the New York bank against the Leadville bank.

Justice Gray said: "The defendant became a depositary of a fund which was, by its own agreement, devoted to one particular purpose and to no other. . . . The defendant became a special depositary of the funds and bound itself to retain it until drawn out under the authority of the latter. . . . The form of the writing in question is not material. . . . In stating therein that the foreign bank's account was credited with the money, those words were controlled in their general application and sense by the clause, that it was 'for the use of Hall' . . . It evidenced a special deposit (22),

(20) Crandall v. Woodhouse, Note 17, above.
(21) 113 N. Y. 593.
(22) The court meant a specific deposit.

made by plaintiffs, and warranted and protected the foreign bank in paying the sum mentioned to Hall, upon its production and surrender. . . . As there was an express contract made with plaintiffs by defendant to do the particular thing, the defendant must be bound by its terms and legal effect. . . . The compact was clear enough, and, whatever forms the defendant went through, they would not be allowed to change it, or to divert the moneys to any other purpose or use. . . . The deposit was a special one for a designated beneficiary, and could not be used or dedicated by the defendant to any other purpose. . . . No system of bookkeeping entries would be allowed to cause the plain agreement of the parties to miscarry. . . . The case of Bank v. O'Hare, 119 Ill. 646, was not unlike the present one."

§ 17. **What is a special deposit?** A special deposit is the deposit of some thing capable of manual delivery, whether it be chattel, chose or money, with the agreement that the identical thing shall be held subject to the depositor's order. In the case of money, it is not essential that the identical coin or bills be preserved, but a special fund must be established and its identity preserved. The depository is a mere custodian without active duties and he is like a bailee (23).

§ 18. **What are trust deposits?** Another class of deposits sometimes confused with general or special deposits, are those where a trustee deposits money in his own name or as trustee. These cases do not involve the question

(23) Morse on Banks, secs. 183, 190.

of whether the deposit is in form special or general, but only the questions of ownership, identity, notice, and tracing. The question arises where the legal representatives of the trustee make claim to the fund, or where a creditor of the trustee depositor seeks to claim the fund, or the bank seeks to offset a claim against the trustee. In such cases, where the fund is in any manner designated as not belonging to a depositor, but is a trust fund, it cannot be treated as the depositor's money. Although the relation between the bank and its depositor is that merely of debtor and creditor, and the balance due on the account is only a debt, yet the question is always open, "To whom in equity does it beneficially belong?" If the money deposited belonged to a third person, and was held by the depositor in a fiduciary capacity, its character is not changed by being placed to his credit in his bank account. If the circumstances, and the relations between the depositor and the bank, are such as impart notice to the bank that the beneficial ownership was outside of the legal title the owner may recover. See Vol. VII, Art. 3, §§ 91-94 (24).

§ 19. **Deposits by agents.** In the absence of equities, the ordinary rules of agency as to undisclosed principals (see Vol. II, Art. 3) do not apply to deposits by agents, and unless there has been some notice and conduct which will operate as an estoppel the banker cannot deny the title of the depositor to the funds deposited by him.

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(24) Philadelphia Bank v. Smith, 104 U. S. 54; Hemphill v. Yerkes, 132 Pa. St. 545; Manhattan Bank v. Walker, 130 U. S. 267; Union Stock Yards Nat. Bk. v. Gillespie, 137 U. S. 411.

§ 20. **Deposits for collection.** A deposit for collection, so-called, is not in its inception, nor, in fact, until its completion, in any sense within the three forms above described, but when the fund is received from the collection it depends upon the contract as to whether it shall become a deposit of any class or be immediately remitted; so that contradictory expressions found in decisions will generally be traced to misconception of distinct things (25); that is, the agency for collection, and the authority to make disposition of the fund collected, are distinct. The former is a distinct branch of the banking business and might well be treated as no part of it.

§ 21. **Bankers as collectors.** It is a very common practice to indorse checks or drafts to the home bank "for collection," or to draw drafts in favor of banks for the purpose of constituting them collectors of debts. The relation is then that of agency (26). The courts are not in harmony as to whether the correspondent is the agent of the bank or of the depositor (27), or as to the responsibility and care required of the bank in choosing the correspondent (28). The funds collected are, however,

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(25) Morse on Banking, sec. 188; Philadelphia Nat. Bk. v. Dowd, 38 Fed. 172; Nonotuck Silk Co. v. Flanders, 87 Wis. 237; Com'l Nat'l Bk. v. Armstrong, 148 U. S. 50; Marine Bank v. Fulton Bank, Note 1, above; St. Louis v. Johnson, 2 Dillon 241, 21 Fed. Cas. 186; National B. & D. Bk. v. Hubbell, 117 N. Y. 384; Indig v. Nat'l City Bk., 80 N. Y. 100; Importers & T. Nat. Bk. v. Peters, 123 N. Y. 272.

(26) Com'l Nat. Bank v. Armstrong, 39 Fed. Rep. 684; St. L. & S. F. Ry. Co. v. Johnston, 133 U. S. 566; Drovers' Nat. Bank v. Provision Co., 117 Ill. 105; White v. National Bank, 102 U. S. 659.

(27) See Wilson v. Carlinville Bank, 187 Ill. 224; Indig v. Nat. City Bank, Note 25, above.

(28) Second Nat. Bank v. Merchants Bank, 111 Ky. 930.

generally credited to the transmitting bank, and in cases of insolvency of either the question arises as to the right to the fund, and here again arises the question of tracing trust funds. (See § 18, above.) The bank receiving paper for collection acquires a lien on the paper and its proceeds to the extent of the depositor's debts to it (28a).

§ 22. **Certificates of deposit.** It is customary for bankers when requested to give a depositor a certificate of deposit, which, unlike a check, affects the deposit, being in effect a promissory note payable on demand which may be transferred from hand to hand, or on indorsement, as the case may be. The certificate is an assignment and is charged against the account. In cases of specific deposit the agreement may be evidenced by a receipt or contract or may rest on oral contract (29).

§ 23. **Pass-books.** Although evidences of the state of account between the parties are not negotiable paper, they may be assigned or constitute means of assigning, or may be the evidence of a gift, but are subject to the equities existing between the original parties (30).

§ 24. **Checks.** A check is in form an inland bill of exchange (see Vol. VIII, Art. 1, §§ 8a, 169 and Chap. VIII), and may be made payable in every respect as a bill of exchange, except that it must be on demand. If payable in any other way than on demand, it becomes a bill of ex-

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(28a) Joyce v. Auten, 179 U. S. 591.

(29) Pardee v. Fish, 60 N. Y. 265; Armstrong v. American Ex. Nat. Bank, 133 U. S. 433; Crandall v. Woodhouse, Note 17, above.

(30) Smith v. Brooklyn Sav. Bk., 101 N. Y. 58; McCaskell v. Sav. Bank, Note 5, above; Witte v. Vincent, 43 Calf. 325; Com. v. Reading Sav. Bk., 133 Mass. 16.

change proper, and, as such, entitled to days of grace where these obtain, protest, notice, etc. (31).

Deposits are generally withdrawn by means of checks, and there is a diversity of opinion as to the effect of making and issuing a check. It is held in some jurisdictions that a check amounts to an assignment pro tanto of the deposit at the time of presentation (32), and that privity between the payee and the bank is created by presentation, and the payee may sue the bank for refusal to pay (33). The English doctrine is contrary to this position, and holds that there is no privity until acceptance. The weight of authority in the United States supports the latter rule (34).

The relation being that of debtor and creditor, with the obligation to honor and pay imposed by operation of law, it is difficult to see the want of privity, and the Illinois rule has much of logic and policy to commend it.

The depositor's balance does not at any time exceed the amount which the banker owes him after deducting all reasonable set-offs which are due; but this is not a matter of mere book-keeping—the facts control the books. A banker has a general lien on the funds of

(31) Boston M. Bank v. Boston State Bank, 77 U. S. 647; Bowen v. Newhall, 8 N. Y. 190; Culter v. Reynolds, 64 Ill. 321; Harrison v. Nicollet Bank, 41 Minn. 488.

(32) It is nowhere pretended that the fund is affected before presentment. Laclede Bank v. Schuler, 120 U. S. 511.

(33) Munn v. Birch, 25 Ill. 21 is the leading case on this doctrine. The law of the place of payment governs the effect in this respect. Abt v. Am. Tr. & S. Bank, 159 Ill. 467; Met. Nat. Bank v. Jones, 137 Ill. 634; 31 Am. Dec. 406.

(34) See notes to Hemphill v. Yerkes, Note 24, above; St. Louis & C. Ry. v. Johnson, Note 26, above.

the customer to secure balances due, but no lien to secure a debt not due which will affect holders of the customer's checks (35). At common law the banker is entitled to the doctrine of set-off, and by statute in some states is established the equitable doctrine of compensation, which recognizes the banker as debtor only to the amount of the balance after deducting credits (36).

A certified check is one which has been presented and marked as good or accepted. When such an acceptance is procured by the payee of the check it is a new contract between the holder and the banker. The original drawer does not contemplate acceptance, but payment; and if, instead, the drawee take the banker's certificate on the check instead of the cash, the drawer is released, and the relations between the banker and the holder are the same as that of depositor and banker (37). When a check has been certified by a bank it is in effect an accepted bill, and the bank becomes primarily liable for it (38). See Vol. VIII, Art. 1, Chap. III, Section 3.

§ 25. **Same: Memorandum checks.** A memorandum check is in the form of an ordinary bank check, with the word "memorandum" written across its face. It is simply evidence of an indebtedness of the drawer to the

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(35) Niblack v. Park Bank, 169 Ill. 517; Mt. Sterling Bank v. Green, 99 Ky. 262; 32 L. R. A. 568; Schuler v. Bank, 27 Fed. Rep. 424.

(36) Bank of Marysville v. Brewing Co., 50 Ohio St. 151; Armstrong v. American Ex. Nat. Bank, Note 29, above.

(37) Smiley v. Fry, 100 N. Y. 262; Auten v. Crahan, 81 Ill. App. 502; Met. Nat. Bank v. Jones, 137 Ill. 634; Lynch v. Bank, 107 N. Y. 179.

(38) Meade v. Albany M. Bank, 25 N. Y. 143; Born v. Ind. etc. Bank, 123 Ind. 78; Met. Nat. Bank v. Jones, 137 Ill. 634; Garretson v. North Atchison Bank, 39 Fed. 163.

holder, and is not to be immediately presented at the bank so as to destroy credit. It is the custom in commercial cities to draw and use such checks merely as due bills (39).

(39) United States v. Isham, 17 Wall. 508.

CHAPTER II

ORGANIZATION AND POWERS OF A BANKING CORPORATION.

The general principles of corporation law apply to banking corporations and only special features need be mentioned—and first as to corporations under state laws. In many of the states the constitution provides for the special regulation of banks and in all the states the subject is treated as a special one, distinct from the law relating to business or other corporations. The charter may be general or special and is always the measure of the powers granted.

§ 26. **Construction of charter.** The charter is, however, to be construed in the light of the common law and it follows that such words as bank, banking, loan, deposit, check, discount, etc., necessarily bring in all the powers implied by such general words. The bank must live up to the object of its creation and may be dissolved by the state for misuser (i. e. abuse) or nonuser of its powers.

§ 27. **Restrictions upon business.** The banking business is such that public policy demands that the management shall keep strictly within the lines of legitimate banking and observe certain well defined regulations as to the character, quality, and quantity of the security it may accept in loaning its money.

The temptation to profit by precarious ventures in the speculative field has led to so many losses that from time to time the states and the nation have declared first one and then another of these acts, which tend to endanger the stability of banks or to injure innocent and confiding persons, criminal.

§ 28. **Same: Crimes.** These crimes are principally of four classes, viz: over loaning to the extent of reducing the available funds below a certain amount proportionate to capital and resources; misappropriation of money—that is applying it directly or indirectly to some purpose outside legitimate channels; loaning without the required security; and receiving deposits after known insolvency. The common forms of theft, embezzlement, forgery, etc., are not peculiar to the banking business and need not be mentioned here. The reason for great strictness in the law as to this subject is found in two directions—first, the danger to public credit; second, the well known private suffering entailed in every bank failure. The letter of our criminal law in this respect is just and adequate, though in some particulars it might properly be more severe, for in almost every case the banker has reason to know that his illegal act will certainly cause the ruin of some or other of his customers. The administration of this branch of our law is in the main all that can be desired, and is not open to the charge that the rich are immune or are unduly favored.

§ 29. **Bank officers.** In the organization of banks, as in other corporations, the control of the affairs and of the business of the corporation is in the hands of a board

of directors. The management of the business is entrusted to another group of officers, but all are under the control of the board of directors. These officers are usually a president, a vice-president, a cashier and his assistant, tellers, and book-keepers. The secretary and the treasurer of the corporation are distinct officers—and their duties may or may not extend to the administration of the banking business conducted by the corporation (1).

§ 30. **Same: The directors.** The directors are the general agents of the bank, but in another sense they are more—they occupy a relation closely analogous to trustees, and more and more the courts are insisting that their neglect is not mere negligence but entails liability. They have an obligation to know all which their duties require they should know (2). The directors have the right to define and limit the authority of all the officers, but, of course, third persons are bound only by the usual and seeming authority except where actual knowledge or notice is given them (3).

§ 31. **Same: Administrative officers.** The general rule applies to all officers and agents. The ordinary officers and employees usually recognized and used in the conduct of the business are held out to the world as having the power to act according to the general usage and practice of banks in the community where the bank is located

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(1) See Zane on Banks, sec. 97 to 102; Nat. Bank v. Drake, 29 Kansas 311.

(2) Prescott v. Haughey, 65 Fed. 656.

(3) Spyker v. Spence, 8 Ala. 333; Auten v. U. S. Bank, 174 U. S. 125.

(4). If then the act is an unusual one the party assuming to deal with the bank must look to the actual authority of the agent. In most cases their ordinary powers are questions of law for the courts, while extraordinary power is always a question of fact. Officers are not indulged in the practice of using the credit or property of the bank for their own personal advantage, and where the transaction itself gives notice, or there is actual notice, a third person dealing with an officer acts at his peril (5).

A cashier for example has no authority to sign accommodation paper (6) or to represent the entire genuineness of checks which he certifies. The issuing of the draft of his bank to pay his own debt has been held to be in the usual course of business (7) but the weight of authority is against the decision, holding that the rule, and the better rule, is one of general corporation law, that an act of an officer done in his own interest is prima facie irregular, and puts the third party on inquiry.

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(4) Morse on Banks, sec. 98; Lloyd v. West Branch Bank, 15 Pa. St. 172.

(5) Ward v. City Trust Co., 192 N. Y. 61.

(6) West St. Louis Sav. Bank v. Shawnee Co. Bk., 95 U. S. 557.

(7) Ward v. City Trust Co., Note 5, above.

CHAPTER III

NATIONAL BANKS.

§ 32. **The creation of national banks.** The creation of national banks is the exercise of the power implied from the express words of the constitution, authorizing congress to establish a system of finance and currency. The policy upon which the people acted was no doubt the necessity for a general and uniform system whereby public credit was to be based upon the security of the whole nation. The direct purpose of the national banking act is to secure public credit by the issuing of bank notes to circulate as money, such notes being founded upon the security of the bonds of the United States (1). Manifestly this is an indirect way to exercise the power to borrow money.

§ 33. **The organization of national banks.** The national banking system is quite simple. Congress by various acts has authorized any five or more persons to organize a national bank; but requires as a condition that its circulation shall be based upon the bonds of the United States, and that the business of all such banks shall be under the direct supervision of an officer of the national government, known as the comptroller of the cur-

(1) Merchants Nat. Bank v. U. S., 214 U. S. 33; Briscoe v. Bank, 11 Pet. 257; M'Culloch v. Md., 4 Wheat. 316.

rency, who has the power at any time to examine into the condition of any national bank and to suspend the business if not found to be in a satisfactory condition.

The organization of a national banking corporation does not differ materially from that of other banking corporations. In fact a great many national banks have been created by transforming an existing state banking corporation into a national bank.

§ 34. **Rights and liabilities peculiar to national banks.** It is impossible, within the space allotted to this subject, to reproduce the national banking statute, and as the banking business conducted by national banks is not changed in its nature, all that is necessary is to notice the rights and liabilities peculiar to national banks. The stability of the system requires that the rights and liabilities of these banks shall be governed by one law, and that, the law of the national government. The states cannot tax national instrumentalities as such. The great case of M'Culloch v. Maryland (2) established that. The states cannot impose penalties upon the national banks or regulate their manner of doing business (3).

While officers and directors may be liable in damages for the violation of relative common law duties, such as assault or fraud, their civil liability, so far as imposed or regulated by congress, is governed solely by the national law, and not by what the state courts consider the common law (4).

(2) Note (1) above.
(3) Schlesinger v. Gilhooly, 189 N. Y. 1.
(4) Yates v. Jones Nat. Bank, 206 U. S. 158.

§ 35. **Same: Share-owners liability.** There is no common law liability upon share-owners for the statute fixes the liability in this respect, providing that share-owners shall be liable in case of insolvency of the bank to an assessment equalling the par value of the stock, beyond the amount invested; or, in other words, the statute imposes a double liability. State laws cannot limit this liability (5).

The liability is imposed upon the real owner. A mere pledgee is not treated as the owner, but the real ownership is a question of fact, and a mere colorable holding in the name of one, while the real ownership is in another will not evade the law (6).

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(5) Christopher v. Norvell, 201 U. S. 216.

(6) McDonald v. Dewey, 202 U. S. 510; Ohio Valley Nat. Bank v. Hulitt, 204 U. S. 162.

CHAPTER IV

CLEARING HOUSES AND CLEARING HOUSE CERTIFICATES.

§ 36. **No necessary relation between clearing houses and clearing house certificates.** Occasionally there arises in the larger cities a condition of affairs which impels the banks to resort to a device for conserving their cash reserve, known as clearing house certificates. In these the general public is immediately interested. At all times in the larger cities and within a convenient radius, there exists the constant business necessity for transferring the money on deposit from one bank to another—and this, in the ordinary course of business, is usually accomplished by means of a general exchange of checks, made at a convenient place under the supervision of what is called a clearing house.

From the fact that the former of these devices is called clearing house certificates, and the latter organization is called a clearing house, one might be led to infer that there is some necessary connection between the two, and that the former is a part of the ordinary business of the clearing house, but this is an erroneous impression. Once the different functions of these devices is understood, the legal aspect of the transactions becomes clear.

§ 37. **What is a clearing house?** A clearing house is a place of meeting and exchanging credits and debits between banks, created by their customers in issuing checks and drafts.

§ 38. **Same: How created.** The clearing house is created by the voluntary agreement of the banks of a certain city or vicinity. There can be no question of the power or right of the banks to enter into such an agreement for this purpose, because the association does not contemplate the creation of any obligation or liability as to the paper handled, except that for the negligent loss or destruction of checks or drafts the members of the association would no doubt be liable, jointly and severally.

§ 39. **Same: No privity with banks' customers.** The customers of the banks associated are not in any sense members of the association nor in any degree in privity with its transactions so far as they relate to the ordinary clearing business (1). In a case involving this question the court said: "As said in Overman v. Bank, 30 N. J. Law 61: 'Where there is no claim that the association called the "clearing house" is an institution authorized by special legislation, or any authority existing in such association in any way to alter or modify the law merchant in regard to checks or commercial paper, such association cannot be held to have power to make usages or rules to bind those who are not parties to its organization. Its usages and rules, if not in conflict with law, may, by the implication of tacit adoption in the contracts of members, bind them in the same way that a general usage of trade

(1) Mt. Morris Bank v. Twenty Third St. Bank, 172 N. Y. 245.

may bind those who deal with reference to it, and who are therefore held to impliedly adopt it. But those who are not bound by such usages, and have not contracted with reference to them, have no right to avail themselves of them to create an obligation against those who are parties to their adoption, and bound to them inter sese only.' And we agree with what was said in Merchants' National Bank v. National Bank, 139 Mass. 518: 'To the regulations of this association, the customers of the bank are not parties, and, whatsoever effect is to be given to them as between the banks, their customers are not in a situation to claim the benefit of them, nor are they liable to be injuriously affected by them'" (2).

§ 40. **How a clearing house operates.** The following account (3) of the New York clearing house is typical of all:

A clearing house serves merely as a meeting place for banks, where in one room every bank which is a member many effect exchanges with every other bank by handing over the checks it has against the other, and receiving in return the checks which the latter holds against it, and settling the difference with the clearing house association in cash. Each bank has a desk, table, or space at a counter in the room and two clerks come from each bank, a delivery clerk and a settling clerk, as they are called. The first delivers checks to other banks,

(2) People v. St. Nicholas Bank, 77 Hun. 159; Crocker-Woolworth Bank v. Nevada Bank, 139 Cal. 564.

(3) With only slight changes the text of this sub-section is an extract from an article in the University Law Review, May 1894, by Frederic E. Perham.

the second receives and lists checks from other banks. All the checks brought by the several banks in the morning are in sealed packages, which are not opened in the clearing house room; the total amount of these checks, but not the items, being marked on a slip of paper attached to the outside of the package. On the basis of the figures on the outside of the packages, the banks settle. Each bank hands up to the manager of the clearing house a statement showing the total amount of the packages of checks it has brought that morning. With this amount it is credited; with the amount of checks it may take away, it is debited. As to the contents of the packages, at this point of time, neither the manager nor any one else can know anything; no one can tell whether the checks are certified or uncertified, good or bad, and until the exchanges are effected no one can tell whether a given bank will be a debtor or a creditor of the clearing house on that morning's transactions.

At the hour fixed for opening the delivery clerk of each bank starts to make the rounds of the desks of the other banks, delivering to each bank the package of checks his bank has against it, and also a small ticket with the amount of these checks written thereon. The settling clerk remains at his desk to receive the packages and tickets from the delivery clerks of the other banks. The figures on the tickets should correspond with the figures expressed on the outside of the packages. The settling clerk receipts to each bank for the amount of checks expressed on the packages and tickets, and at the same time enters the amount on his balance

sheet. This transaction is all over in ten minutes, and while the settling clerk remains, his companion gathers up the packages delivered to his bank and takes them to the bank. The settling clerk then figures up the total amount of the checks turned over to his bank, as expressed on the tickets he has received, and hands up a statement of the total to the clearing house manager. For this amount his bank is a debtor of the clearing house association. If this total is greater than the total of checks brought by his bank, his bank is a debtor to the clearing house for the difference; if the total is less, his bank is a creditor of the clearing house for the difference. It will be noticed that as totals only are considered, the manager cannot tell whether any bank is a debtor or a creditor of any other particular bank, but each is a debtor or a creditor, as the case may be, of the clearing house.

It is evident that the total amount of all the checks taken away by all the banks can never be either greater or less than the total amount of the checks brought by all the banks. The total of the credits handed up to the manager must equal the total of the debits handed up to him. If these totals are not equal, there must be a mistake somewhere, and the difference being announced by the manager, all the settling clerks set to work to find it. If it is not found in a few minutes, an order is given to pass all the balance sheets around the circle of banks represented and each bank's balance sheet is gone over by the settling clerk of another bank. When the difference is found and the manager's totals balance, the clearing is over. The banks who are indebted to the clearing

house must pay their balances in cash at an hour appointed; the banks who are creditors of the clearing house, receive payment in cash from the clearing house. No credits are paid until all the debits are received.

Every bank settles its differences with the clearing house solely on the figures shown on the outside of the packages and on the tickets handed over by the delivery clerks. If there is any error in these amounts, for example, if the package received from the First National bank should purport to contain checks amounting to $21,000, and should in fact contain checks amounting only to $20,000, these errors are rectified solely between the sending and receiving banks, and are not reported to the clearing house. If there should be in the package any bad checks, these must be returned by the bank receiving them to the bank sending them, before 3 p. m.

Under this arrangement, the payment required of the clearing house to a creditor bank upon a check presented, must be regarded as only provisional until the hour stipulated for the return of checks, to become complete only in case the check is not returned at that time. And if by any mistake of fact the return is not so made, then as between the two banks, it is treated in Massachusetts, as a payment made under a mistake of fact, precisely to the same extent and with the same right to reclaim, which would have existed if the payment had been made by the simple act of passing the money across the counter directly to the payee on the presentation of the check. The manifest purpose of a rule fixing a time before which checks must be returned and claims made, is to fix a time

at which a creditor bank can be authorized to treat the check as paid, and be able to regulate with safety its relations to other parties. A mistake can be corrected at any time after it is discovered, if it places the party to whom the check is returned in no worse position than he would have been in if it had been returned within the stipulated time (4). But it is held by some courts that mistakes cannot be corrected after the time fixed by the clearing house rule, because it is competent for parties to agree that they may not have the right to correct mistakes unless done within a limited time (5). Until the hour fixed for returning checks, no apparent acceptance of a bad check binds the bank apparently so accepting. Where a bank received through the clearing house a check drawn on it in favor of another bank, and filed the check and credited it to the bank from which it received it, and which cleared for the payee, but before the hour fixed by the clearing house rules for returning bad checks, the drawer of the check, hearing that the payee had failed, and having a defence against the check, notified the drawee to stop payment, and the drawee did so by returning the check to the bank from which it had received it, the court held that the filing and crediting of the check by the drawees was not an unconditional acceptance of the same, and they were not liable to the sending bank

(4) Merch. Nat. Bank v. Nat. Eagle Bank, 101 Mass. 281; Exch. Bank v. Bank of North America, 132 Mass. 147; Merch. Bank v. Nat. Bank of the Commonwealth, 139 Mass. 513; Citizens Central Bank v. New Amsterdam Bank, 128 Appellate Division (N. Y.) 554-1908.

(5) Preston v. Canadian Bank of Com., 23 Fed. R. 179.

for the amount, and consequently might recover the same (6).

§ 41. **Construction of rule requiring prompt return of checks.** The rule requiring the prompt return of checks is interpreted according to the spirit of its language and purpose and in a quite recent case the court of New York, in construing a rule that "in no case shall they be retained after one o'clock," and in order to save a forfeiture, held that the delivery to a messenger with sufficient time ordinarily for him to reach the other bank before one o'clock was a compliance with the rule (7).

§ 42. **Clearing house certificates.** Clearing house certificates are quite exceptional and are resorted to only in the case of great financial stress. They come about by reason of an agreement between all of the banks, or a number of them, members of the clearing house, to protect the credit of each and all by permitting the issuance of certificates of the clearing house promising to pay the amounts named. The holder of a draft or check on a bank is not obliged to accept from the bank upon which it is drawn anything but money. Plainly, therefore, clearing house certificates rest for their efficiency on the public spirit of the community and the combined credit of the associated banks which constitute the clearing house and have agreed to the issuance of the certificates.

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(6) Ger. Nat. Bank v. Farm. Dep. Bank, 118 Pa. St. Rep. 294.
(7) Central Nat. Bank v. New Amsterdam Bank, Note 4, above.

CHAPTER V

TRUST COMPANIES

§ 43. **Legal and illegal trusts.** No word in the legal vocabulary has a more varied meaning than the word trust. Trusts are said to be the especial favorites of the courts of equity and in truth pure trusts are the first off-spring of equity. On the other hand trusts are said to be the enemy of commerce and the very embodiment of monopoly. But there are several varieties of trusts. These are no doubt all clearly explained in other parts of this work (see Vol. VII, Art. 3), but a word as to the general nature of trusts will enable us to approach this subject with a clearer understanding. Wherever one person holds the title and control of property of any class in which he himself claims no beneficial interest, general or special, but which, on the contrary, he holds for another, whether this is by express or implied contract, or because of a peculiar status or relation, the holder is called a trustee and the beneficial owner is called the cestui que trust or beneficiary. This is the legal trust.

The illegal trust is quite different, but it has the one feature in common with the lawful trust, that the trustee holds and controls the property, but by an arrangement called a combination, the object being always to control

trade and commerce, or, as it is said, to restrain trade by monopoly.

§ 44. **The nature of a trust company.** A trust company is so named because its principal business is to hold titles for others who are the beneficial owners in order to facilitate the management of affairs, all of which have a lawful object. It is, in other words, an incorporated trustee. Any natural person, compos mentis, may be a trustee and it has been held that a municipal corporation might be a trustee. The power then of the state to charter a corporation with power to accept and execute trusts cannot be doubted.

In truth the foregoing explains all there is to the general object of a trust company. The usual power of a trust company is to accept trusts of every kind and nature.

§ 45. **Same: Its banking power.** With respect to the banking features of a trust company there is greater difficulty, for outwardly most of our trust companies receive deposits of money, general, special, and specific, and pay out money on checks precisely as do the regular banks. Bearing in mind that, except as restrained by law, and subject to regulation by law, any one may do a banking business, and keeping in mind that the powers of a corporation are only such as are expressly or impliedly granted by its charter, it may be readily seen that whether a trust company has the right to do a general banking business depends upon its charter; for a corporation authorized to conduct a definite business, expressed in generic terms or specially defined, cannot go outside of that orbit. Such a transgression is called

ultra vires the corporate powers. See Vol. IX, Art. 2, Chap. IV, sections 2 and 4. It follows therefore that no general rule can be laid down that a trust company can or cannot conduct a banking business, because that depends on the charter; and under some charters it has been held that a company might conduct a savings bank (1).

As a matter of course a trust company doing a banking business is subject to the statutory regulations governing banking.

§ 46. **Same: Acts ultra vires.** Having in mind the limited space at our disposal in this work the following extracts from an illustrative case have been chosen because they explain the general principles applied in construing such charters, make clear the idea of ultra vires, and mention the banking features sufficiently for our purpose. This case constitutes a very salutary guide to officers of banks and trust companies and suggests to others the necessity for considering the powers of officers who perform acts on the part of their corporations. It also suggests and explains many of the important steps and devices used in organizing and managing corporations, and its careful perusal and study will guide one in many analogous situations.

In Gause v. Commonwealth Trust Co. (2), the questions arose under an agreement by the defendant trust company to underwrite and guarantee, as well as to act as de-

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(1) Bank Com. v. Security Trust Co., 75 N. H. 107.
(2) 196 N. Y. 134.

pository for, the bonds of the United States Shipbuilding Company. The Court said:

"The defendant was organized March 29, 1902, pursuant to article 4 of the Banking Law of this state as it then existed. The statute as it existed at that time defines a trust company to mean a domestic corporation 'formed for the purpose of taking, accepting and executing such trusts as may be lawfully committed to it, and acting as trustee in the cases prescribed by law, and receiving deposits of moneys and other personal property, and issuing its obligations therefor (3), and of loaning money on real or personal securities.' . . . The powers of a trust company are expressly defined by statute and so far as applicable to this decision they are:

. . . .

"2. To receive deposits of trust moneys, securities and other personal property from any person or corporation, and to loan money on real or personal securities.

. . . .

"9. To purchase, invest in, and sell stocks, bills of exchange, bonds and mortgages and other securities; and when moneys, or securities for moneys are borrowed or received on deposit, or for investment, the bonds or obligations of the company may be given therefor, but it shall have no right to issue bills to circulate as money.

. . . .

(3) It is at this point that one would look for any limitation on the power conferred by the words—"receiving deposits." It is sometimes expressed as "receiving and holding trust deposits." Such an expression would indicate a limitation too narrow to authorize the doing of a banking business.

"The purposes of the defendant's organization are very material in determining the question as to its authority to make the alleged agreement. Where a corporation is organized for business or trading purposes and the only persons interested therein other than its business creditors are its stockholders and their only interest therein is to secure dividends upon their investment, the question of ultra vires is of comparatively small importance except in behalf of the people of the state in their public capacity, and the courts treat the question as it relates to such a corporation very differently than they do in the case of a banking corporation. (Hess v. Sloane, 66 App. Div. 522; affd. on opinion below, 173 N. Y. 616.)

"A banking corporation occupies a different relation to the public in that it invites individuals to submit to it the possession and care of their money and property. All banking institutions occupy a fiduciary position. We have herein quoted the statutory definition of that form of a banking institution known as a trust company, and the statutory statement of its powers and the purposes of its organization. Such powers and purposes are primarily fiduciary. Their primary work is of a trust capacity and to a large extent they take the place of individual administrators, executors, guardians, committees, receivers and trustees. They receive appointment from the courts in trust capacities without giving a bond. It is assumed that the statutory restriction and regulation of their powers will make the execution of a bond in each particular instance unnecessary.

"The courts, in considering the effect of ultra vires acts, have always recognized the distinction between business

and trading corporations and corporations whose purposes are largely fiduciary.

"In Leavitt v. Yates (4 Edw. Ch. 134, 156) the court, referring to a banking corporation, say: 'They can have no right or power to borrow money or contract for loans to enable them to engage in speculations, or in mercantile or other business having no sort of relation to and forming no part of the ordinary business of a bank. . . . The unauthorized acts of agents are not binding on their principals; and directors are but agents or ministers, intrusted with powers to be exercised for the benefit of others. Those who have contributed to the formation of a banking capital by becoming shareholders; those who have intrusted their money on deposit, or have otherwise fairly become creditors of a bank, are entitled to protection against any unauthorized assumption of powers by the directors, or any misapplication of the assets or funds of the institution. Its property cannot be diverted to other purposes, or be used up in speculations foreign to the business of banking without a struggle for its recovery and an effort to reclaim it. A rigid adherence to this principle works no injustice, although it may sometimes produce a seeming hardship. Persons dealing with corporations or associations of limited capacity, must look to the character of the transactions they engage in with them. The law under which they act, and the business they are authorized to perform, is all written in the public statute book, with which every man is supposed to be acquainted.'

"In Nassau Bank v. Jones (95 N. Y. 115, 120) this court, referring to a contract relating to the subscription

to the stock of a railroad corporation, say: 'Even a cursory view of the provisions of the statute under which the plaintiff was organized, and the cases giving construction to the powers thereby conferred, renders it quite clear, that the contract under which the plaintiff claims was not only ultra vires, but contrary to public policy. . . . The solvency of these institutions was guarded by special provisions and limitations in the act authorizing their incorporation, and has ever since been the object of sedulous care, both on the part of the legislature and of the courts. . . . The language employed in the act defines their power and duties, and excludes by necessary implications a capacity to carry on any other business than that of banking, and the adoption of any other methods for the prosecution of such business than those specially pointed out by the statute. . . . The spirit of the law, as well as a sound public policy, forbid these institutions from risking the moneys intrusted to their care in doubtful speculations or enterprises.'

" 'There can be no doubt that speculative contracts entered into for the sale of stock by the bank at the stock board, or elsewhere, subject to the hazard and contingencies of gain or loss, would be ultra vires, and a gross perversion of the powers conferred by its charter. But the bank, as the owner of stock, could sell it, as any other owner of similar property, and could employ a broker to sell it at the board.' (Sistare v. Best, 88 N. Y. 527, 533.)

. . .

"The legislature intended and the public interests demand that trust companies shall be confined not only

within the words but also within the spirit of the statutory provision which declares that a corporation shall not possess or exercise any corporate powers not given by law or not necessary to the exercise of the powers so given. Such authority does not permit a trust company to enter into speculative and uncertain schemes or, unless under peculiar circumstances not disclosed in this case, become the guarantor of the indebtedness or business of others. Its authority to buy and sell stocks and bonds does not authorize it to indulge in hazardous promoting schemes although it may hope from the successful launching of such schemes to make large commissions and receive large bonuses. . . .

"The guaranty of said notes in this case, as well as the alleged guaranty to the plaintiff, was without any legitimate or adequate basis. Its president, as stated, assumed that there was no risk in what he did and directed, and he was doubtless influenced by a sentimental reason arising from the extent to which the defendant had been connected with the general scheme of floating the shipbuilding company. It did, however, create a hazard so great as to involve the very life of the defendant, and in our judgment it was wholly without authority. The result of such hazardous and reckless dealings and acts by the officers of trust companies is well illustrated in this case, as it appears that the defendant was organized with a large capital and paid in surplus in the spring of 1902, and within a few months thereafter was shorn of its surplus and compelled to reduce its stock to a small part of the original issue, and it has still upon its hands this

serious litigation. If such business methods are authorized by statute and approved by the courts the purpose of the organization of trust companies would fail and result in a trap to those invited by the legislature to submit to such corporations their fiduciary accounts."

APPENDIX A.

NEGOTIABLE INSTRUMENTS.

§ 2. What is meant by the "custom of merchants," or the "law merchant"?

What relation did it have to the law of negotiable instruments?

§ 3. What is the difference between a common law debt, and the obligation expressed in a promissory note or bill of exchange?

§ § 4, 5. Richards sells to White a horse with a warranty of soundness, taking in exchange White's promissory note for $100, and also a contract by which White agrees to work for him for six months. Richards assigns the note and the contract to Donlin. The horse proves unsound, whereby the warranty is broken. What are Donlin's rights on the note and on the contract?

§ 6. Suppose, in the preceding case, that Richards, instead of assigning the note to Donlin, had indorsed it in blank and had lost it, and Donlin had found it and had sold it to a bona fide purchaser for value, without notice. What would have been the rights of the latter?

§ § 8a-28. Which, if any, of the following are good negotiable instruments?

(§ 8a.) "Chicago, July 1, 1909.

Pay to the order of John Carson five hundred dollars. $500.

RICHARD STEVENS."

(§ 10, 11.) "Chicago, Feb. 1, 1910.

I have borrowed from Richard Smith One Hundred Dollars ($100.)

CHARLES ASHER."

(§ 13.) "Boston, Feb. 1, 1905.

Three months after date I promise to pay to the order of William Jones his bill against Thomas Williams, amounting to Two Hundred Dollars.

JOHN SMITH."

(§ § 14, 15.) "Chicago, Feb. 1, 1910.

Pay to the order of Robert Morse fifty dollars ($50), if the amount now due and owing to me on account of com-

missions, on sales made by me last month equals said amount, and charge the same against such commissions.

HARRY BURSON.

To the Lee and Henry Mfg. Co., Chicago."

"Akron, Ohio, July 1, 1909. Please pay to James Holt, or his order, twenty-five dollars ($25), for which you may re-imburse yourself by holding the amount out of my next month's salary.

To the Diamond Rubber Co.

HENRY JOHNSON."

"$5,000. Buffalo, New York, Aug. 10, 1909.

Six months after date, for value received, I promise to pay to the order of Joseph Weingarten Five Thousand Dollars out of the proceeds of the sale of five thousand (5,000) tons of iron ore now registered in my name at the docks of Norton & Co., in this city.

W. S. BURCHARD."

(§ 16.) "$10,000. Chicago, June 1, 1909.

For value received I promise to pay George Willams or order Ten Thousand Dollars, three months from date. This note is given in consideration of a promise by said George Willams (contained in a writing of even date herewith) to convey on the day of the maturity of this note an estate described in said writing.

EDWARD MOSS."

(§ 17.) "$100. Grand Rapids, Mich., Sept. 3, 1909.

Thirty days after date, for value received, I promise to pay to the order of J. D. Graff, one hundred dollars, together with 10 per cent. of the amount which may be paid to me by the Grand Rapids Furniture Co., as commissions on sales made by me during said thirty days.

S. K. WHEELER."

(§ 22.) "$500. Chicago, Dec. 1, 1909.

For value received, I promise to pay to the order of L. M. Whitford Five Hundred Dollars.

B. J. LEWIS."

"$100. Chicago, May 15, 1909.
Ten days after sight, pay to the order of Henry Ashton, One Hundred Dollars and charge to my account.
R. L. MURPHY.
To George Sullivan & Co."

(§ 23.) "£50. Chicago, June 15, 1905.
Sixty days from date, for value received, I promise to pay to Roscoe Mason or order, Fifty Pounds Sterling, payable at the Commercial National Bank in Chicago.
S. K. BIDWELL."

(§ 26.) "$100. Chicago, Aug. 5, 1908.
Ninety days after date, for value received, we promise to pay to the holder hereof, One Hundred Dollars; or at his option to deliver to him a good warranty deed conveying a lot in Shufeldt's addition to Chicago.
THE AMERICAN LAND & INVESTMENT CO.
By T. H. Lathrop, President."

(§ 27, 28.) "$1000. Chicago, Oct. 11, 1906.
One year after date, for value received, I promise to pay to the order of myself, One Thousand Dollars, with interest at six per cent per annum.
J. H. HAMMOND."

§ § 30, 31. In the following note, can the Rookwood Mfg. Co., be held liable as a maker?

"$2,000. Newark, N. J., March 10, 1903.
Thirty days after date, for value received, we promise to pay to the order of L. M. Conley, Two Thousand Dollars.
P. H. ASHTON, President of Rockwood Mfg. Co.
F. O. FISHER, Secretary."

§ 35. Is the following a good negotiable instrument?

"Chicago, March 5, 1910.
The Hibernian Banking Association.
Pay to the order of the County Treasurer of Cook County, Two Hundred Thirty-Seven Dollars. ($237.)
R. M. MURPHY."

§ 47. Defendant wrote his name on a blank piece of paper and left it with the proper officers of his bank for the purpose of having them use it to identify his signatures. One of the bank employes took the paper and wrote upon it a promissory note above defend-

ant's signature. The paper passed to an innocent purchaser, who sought to hold the defendant liable upon it. What decision?

§ 48. Caswell, who was on friendly terms with defendant, represented to him that he had purchased shares of a corporation at 25 cents a share, which was less than their market value, and would sell one-half of his purchase to defendant at the price he had paid for it, and that the stock would not be issued until some time in the future, at which time, if defendant should so elect, Caswell would return to him the note given for the stock and take it in his own name. Caswell had in fact paid only 10 cents a share for the stock, which was its full market value. Caswell indorsed the note to plaintiff, who was a bona fide purchaser for value without notice of any of the facts above set out. What are plaintiff's rights on the note?

§ 49. Baker sold to Davidson a horse with a warranty of soundness, and in payment therefor, Davidson made a promissory note to Baker's order, which however he retained in his possession and did not deliver. Shortly afterward, Davidson claimed that the horse was unsound, and refused to pay for it, destroying the note. Baker brought suit against Davidson, declaring upon the note as a lost instrument. What decision?

§ 52. Brown made and executed a promissory note payable to the order of Stuart, and delivered it to the latter upon condition that Stuart should also abtain the signature of Brown's brother to the note, before attempting to give it any effect. Stuart, without obtaining the other signature, sold and transferred the note to the plaintiff, who paid value for it and had no notice of the condition. What are his rights upon the note?

§ § 53, 54. Defendant signed a promissory note to the order of Clark, leaving a blank for the amount of the note, and delivered it to Clark, authorizing him to fill in the blank with the amount $100. Clark, in excess of his authority, inserted in the blank the amount $200, and transferred the note to the planitiff, who was a holder in due course without notice of the fact that the note had been executed and delivered in blank. What are plaintiff's rights upon the note?

§ § 57-60. Is a consideration necessary to support a negotiable instrument?

Is a consideration necessary to support the promise of an indorser?

Is an antecedent or pre-existing debt sufficient consideration to support a negotiable instrument payable on demand?

§ 63. Defendant made a negotiable promissory note to the order of the plaintiff and presented it to him as a gift. Plaintiff brought suit against defendant upon the note, but made no attempt to prove a consideration; nor was the question of consideration raised by the defendant as a defense. Defendant appealed from a judgment against him on the ground that the note was invalid for want of a consideration. What decision?

§ 64. Burrows was indebted to Friedman in the amount of $100 on a grocery bill. Friedman drew a bill of exchange on Burrows for $100 payable to the order of Lawson, and delivered it to the latter. Burrows refused to accept the bill and Lawson brought suit against him. What decision?

§ 65. Is an oral acceptance of a bill of exchange binding under the Negotiable Instruments Law?

§ 67. A bill of exchange drawn on Rogers and Co., was presented to them for acceptance, and instead of writing their acceptance upon the bill, they wrote a letter to the payee, stating that they accepted the bill. The payee negotiated the bill to the plaintiff, showing him the letter, and the latter purchased the bill in reliance upon the letter. Can he hold the drawees as acceptors?

Would the result be any different in the preceding case if the plaintiff had not been shown the drawees' letter?

§ 68. What is meant by a "virtual acceptance?"

A banking firm made an oral contract with one of their customers to accept any bill which he might draw upon them. He drew a bill upon them for $100 and negotiated it to the plaintiff, who had full knowledge of the oral contract and purchased in reliance upon it, paying full value for the bill. Can he hold the drawees as acceptors?

§ 70. What is meant by a general acceptance as distinguished from a qualified acceptance?

Can a virtual acceptance be qualified?

§ 77. A bill drawn upon Rush & Co., was presented to them for acceptance and acceptance was refused. The payee then took the bill to the defendant with whom the drawer also dealt and the

defendant accepted it by writing an acceptance upon the face of the bill in the usual manner. The bill was afterwards negotiated to the plaintiff. Can he hold the defendant as an acceptor?

§ 78. A consignor of goods drew a bill upon the consignee for the amount represented by the value of the goods. Upon the bill being presented to the drawee for acceptance he refused to make an unqualified acceptance, but offered to make an acceptance conditional upon the goods being sold, which the holder refused to take. Was the latter justified in treating the bill as dishonored?

§ 80. What is meant by negotiation of a bill or note?

§ 82. What is necessary for the negotiation of a bill or note payable to bearer?

Ashton was the holder of a note payable to bearer. He gave it to his agent, the plaintiff, for the purpose of collection, and the latter being unable to obtain payment from the maker, brought suit against him upon the note. Can the maker show as a defence, want of authority in the plaintiff to sue?

§ § 88-98. What is meant by a special indorsement? An indorsement in blank? A restrictive indorsement? A qualified indorsement? A conditional indorsement?

§ 100. What elements must concur to constitute one "a holder in due course" of a negotiable instrument?

§ 102. Defendant is sued upon a negotiable promissory note by a holder in due course. Can he defend upon the ground that he was an infant at the time he executed the note, this fact not having been known to plaintiff at the time that he took the note?

§ § 102, 103. A banker, in due course of business, is asked to discount a note, the note upon its face appearing regular in all respects, and he having no notice of any facts which might operate to invalidate the note, nor of any fact, which should put him on his guard. If he does not know the maker of the note nor the circumstances of its execution, of what facts should he satisfy himself before taking the note?

§ 108. What is meant by "constructive notice" of defects in a negotiable instrument?

§ 109. Suppose in the case under § § 102-103, above, that the note had been offered to the banker in question for discount after

the date of its maturity. What further considerations should guide him in deciding whether or not to take the note?

§ 114. A swindler, by fraud, induced defendant to execute and deliver to him two negotiable promissory notes for $50 each. One he sold to plaintiff for $40, and the other he pledged to plaintiff to secure an advance of $25, plaintiff being without notice of the swindler's wrong, and acting bona fide in each case. For what amounts can plaintiff hold defendant liable on the two notes?

§ 117. Dodge was the holder in due course of a negotiable promissory note for $100 made by defendant. After he had obtained it, in due course of business, for value and without notice of defects, he learned that the consideration for which it had been given had failed. Thereupon, knowing that the note was valid in his hands, but not wishing to appear to be taking advantage of the misfortune of defendant, who was a friend of his, he sold and endorsed the note to plaintiff for $28, plaintiff being fully informed of all the facts. Is defendant liable to plaintiff upon the note, and if so, for how much?

§ 124. What is an aval?

§ § 132, 133. A bank which was sued as acceptor of three bills of exchange set up as a defense in one case that the drawer's signature was a forgery; in another that the body of the bill had been materially altered between the time of drawing and accepting; and in the third case that, between the time of drawing and accepting, the body of the bill had been materially altered and the drawer's name erased and re-written, without authority. Which, if any, of these defences is valid?

§ 136. What warranties are made by the seller of a negotiable bill or note?

§ 141. What is the importance of presentment for payment of a bill or note with indorsers?

§ 142. When must presentment be made?

§ 147. Where must presentment be made, when no place of presentment is specified?

§ 151. To whom must presentment be made when several persons, not partners, are primarily liable on the instrument, and no place of payment is specified?

§ 155. After presentment of a bill to the drawee for payment, and its dishonor, what is the next step which is necessary to fix the liability of the drawer (and indorsers, if any)?

§ 162. What is the time within which notice of dishonor must be given, in order to fix the liability of an indorser?

§ § 168-170. What is meant by a foreign bill of exchange?

In the case of a foreign bill of exchange, besides presentment and notice of dishonor, what further act must be performed in order to fix the liability of the drawer (and indorsers, if any)?

§ 172. What is the effect of certification of a check?

§ 173. Within what time must a check be presented for payment in order to preserve the right of recourse on the drawer in case of non-payment by the bank?

§ § 175-177. What is meant by discharge of a negotiable instrument?

What is the effect upon a negotiable instrument of its payment before maturity?

APPENDIX B.

GUARANTY AND SURETYSHIP.

§ 1. What is meant by a surety or guarantor? What are co-sureties?

§ § 3, 4. Wilkins makes a promissory note to the order of Mason for $1000. Wilkins' father writes upon the back of the note: "For value received, I hereby guarantee the payment of the within note," signing his name to the words quoted. What are the rights of Mason against the elder Wilkins?

Baker and Talmage executed a bond in form as follows: "Know all men by these presents that we, Lewis H. Baker, as principal, and D. W. Talmage, as surety, are firmly bound, etc.," to which they affixed their names and seals. Is Talmage's liability to the obligee direct or collateral?

§ 5. What was the effect of the fourth section of the old English statute of frauds, upon contracts of guaranty and suretyship?

§ 6. Defendant, in order that his son might have credit at plaintiff's store, stated to plaintiff, orally, that he (defendant) would pay for all goods which the son should fail to pay for. Is the defendant's promise within the statute of frauds?

§ 8. Defendant had been asked to preside at a political meeting which had been called for the purpose of aiding the campaign of a friend of his who was a candidate for alderman. Defendant on his own responsibility engaged a band to play at the meeting, agreeing with the band-master that, since there was no one else to whom the musicians could look for payment, he would see that they were paid. Was defendant's promise within the statute of frauds?

§ 9. Defendant was manager of an incorporated Grand Opera Company, for which he worked upon a fixed salary. The company being in failing circumstances and behind in the pay of its musicians, and they threatening to leave, defendant promised them that if they would play at the next performance, he would see that they were paid. Was his promise within the statute of frauds?

§ § 10-12. Plaintiff loaned money to Fielding, taking the latter's note signed also by the defendant as surety. On these facts, is want of consideration available to defendant as a defense to an action against him as surety?

Suppose in the preceding case that the defendant had added his name to the note as surety after the note had been executed and delivered by the principal debtor and the plaintiff had advanced his money. What would be the rights of the latter against the surety?

§ § 13, 14. Defendant agreed with one Lemon to be a surety on the latter's note, and in pursuance of their agreement, Lemon's agent made a promissory note which defendant signed and gave to the agent, authorizing him to negotiate it only upon first obtaining Lemon's signature to it. The agent, without obtaining Lemon's signature, transferred the note to the plaintiff. What are the plaintiff's rights against the defendant?

§ 15. Defendant signed as surety a note payable three months after its date. Afterwards the principal debtor, before negotiating the note, changed the wording so as to make the note payable two months after its date. Does this affect the liability of the surety?

§ 18. Defendant signed a note with another, the form of the note being: "For value received, we, each of us a principal, promise, etc." As against a holder in due course suing on the note, can the defendant show that he is a surety and not a principal?

§ 21. A railroad corporation took a lease of a dwelling house to be occupied by one of its employes, the act being unauthorized by the company's charter and ultra vires. Can the president of the company, who signed the lease individually as a surety, be held liable for the rent?

§ 24. Defendant, a surety on a note, offered to show as a defence to a suit against him on the note that shortly after the note matured the principal debtor made preparations to leave the state with a large amount of property in his possession, and that the creditor might have begun attachment proceedings and thereby satisfied his claim in full out of the principal debtor's property, instead of which he had taken no steps against the principal debtor and had allowed him to remove his property from the state. Do these facts make a defence?

§ § 26, 27. Is the liability of a surety in anywise affected if the creditor agrees with the principal debtor, without consulting the surety, to extend the time of payment?

§ 31. The maker of a promissory note secured by a mortgage on realty and endorsed by the defendant as surety requested the holder of the note to release the realty, and the latter, thinking himself

sufficiently secured by the note with a surety, did so. Did this affect the surety's liability?

§ 36. What is the effect, if any, upon a surety's liability, of the failure of the creditor to sue the principal debtor upon the surety's request?

§ 37. Is it necessary to give notice to a guarantor of the principal debtor's default?

§ 38. Plaintiff, a merchant, wrote to defendant asking whether he would guarantee the credit of his son for any purchases which he might make, and defendant answered that he would. Plaintiff thereupon sold goods to the son, but gave no notice thereof to defendant until some time afterward, and shortly before the bringing of the suit, when a demand was made upon defendant to pay for the goods which his son had bought. Is defendant liable?

§ 41. Defendant is sued as surety upon a note. At the time the note was made the principal debtor was insolvent, which fact was known to the creditor, but not to the surety, and such fact was not disclosed to the surety when he entered into the contract. Is his liability thereby affected?

§ 42. Suppose in the preceeding case that the fact of the principal debtor's insolvency was not known to the creditor, although, by inquiring he could have discovered such fact. Would the case be altered?

§ 44. Defendant was surety for the faithful conduct of a cashier in plaintiff's employ. The cashier embezzled $500, which fact became known to the plaintiff. In order to avoid a scandal, and upon the cashier's solemn promise of faithful conduct in the future, plaintiff continued him in his employ, it being agreed that the amount embezzled should be restored to plantiff by having certain amounts withheld from the cashier's salary. At the same time plaintiff adopted certain precautions in his methods of doing business which he honestly thought would make it impossible for the cashier to repeat the offense. Two year's later, and about a year after he had fully restored the $500 first embezzled, the cashier embezzled $1000 and fled. Is defendant liable on his contract of surety, and if so, for how much?

§ 57. What is the danger to be anticipated by a creditor in taking the obligations of co-sureties as a joint obligation, in the absence of a statute making such an obligation joint and several?

§ 58. What is meant by subrogation?

§ 59. Plaintiff was surety upon a note given by Randall to the defendant. Being about to pay the note, plaintiff learned for the first time that some time after the note was given Randall gave to the defendant several shares of stock in a corporation to hold as security for the note. Upon paying the note, has plaintiff any right of subrogation in the shares of stock?

§ 60. When a surety pays his principal's debt, what should he ascertain, as a matter of precaution, with regard to possible security held by the creditor, in order to be able afterwards to enforce his right of subrogation against the principal debtor?

§ § 63-65. What are the rights of a surety with regard to fraudulent conveyances made by his principal (1) before the surety has paid the debt, and (2) after he has paid the debt?

§ 67. What is the difference between the rule at law and the rule in equity with regard to the extinguishment of a specialty upon payment by a surety?

§ 68. What is the rule with respect to the payment by a surety of a judgment rendered against him and the principal, as regards his right of subrogation to the benefits of such judgment?

§ 71. A surety paid his principal's note when it fell due. Six years afterwards he demanded repayment from the principal, and upon the latter's failure to pay, brought suit. The statute of limitations in force in the jurisdiction barred actions upon implied contracts after five years, and upon written agreements after ten years. Are plaintiff's rights barred?

§ 76. If a surety pays his principal's debt before it matures, what are his rights against the principal?

§ 80. What rights against his principal has a surety who gives his own negotiable note in payment of the debt?

§ 82. What is the limit of the amount of damages which a surety can obtain from his principal, by reason of the latter's non-payment of the debt?

§ 83. Under what circumstances has a surety a right of action against his principal, for the latter's failure to perform the obligation, without the surety himself performing it?

§ 89. What is meant by contribution?

A surety paid his principal's debt. Afterwards he learned that a second surety had signed the contract some time after he had himself signed, the second surety being also, at the time he signed, in ignorance of the first. Has the first surety any right of contribution against the second?

§ 91. A surety pays his principal's debt of $1200. What are his rights of contribution in equity against three co-sureties, of whom one is insolvent, another a non-resident, and the third a resident of the jurisdiction and solvent?

§ 93. What are the rights of contribution of a surety who has paid his principal's debt, as in the preceding case, against his co-sureties at law?

§ 100. What is meant by exoneration?

§ 101. When does the right to compel exoneration arise?

APPENDIX C.

INSURANCE.

§ 1. Where did the law of insurance have its origin? In what form?

§ 2. What is the doctrine of indemnity? To what forms of insurance is it applied?

§ 3. What is the difference between a valued and an open policy?

§ 4. Jones takes out a life insurance policy with the Home Insurance Company. The policy is payable to Jones' wife. Mrs. Jones in order to secure a loan assigns the policy to Watkins. Who is the insurer? The insured? The beneficiary? The assignee?

§ 5. Whence is the right to be an insurer derived?

§ 6. In what cases will subsequent insanity avoid an insurance policy?

§ 9. Why must a person have an insurable interest in order to take out insurance?

§ § 10, 11. Farson has an option on a building for one year. Has he an insurable interest?

Property is devised to Watson for life and upon his death to Williamson for life. Has Williamson an insurable interest?

The city of New York leased vacant lots owned by it for five years at an annual rental to an association on condition that the association should erect thereon a building to be used for the purpose of an industrial exhibition, the property to revert to the city at the end of the term. Did the city have an insurable interest in the property?

Watkins insures property in the Mutual Insurance Company. The Mutual company insures the same property in the Denver Insurance company. Is this second policy good?

§ § 12-14. Smith is suing Green for a tort which the latter has committed. There is a reasonable doubt whether he will be able to recover damages or not. The action is one which will not survive death. Has Smith an insurable interest in Green's life?

Has a creditor an insurable interest in the life of a debtor after his discharge in bankruptcy?

§ § 15, 16. A merchant having a policy of insurance on his stock of goods transferred the goods to Watkins who immediately there-

after sold them to the merchant's wife. The merchant then, with the consent of the insurance company, transferred the policy to his wife. The goods are destroyed by fire. Can the wife recover on the policy?

§ § 19, 20. Carney owes Cook $2,000. Carney takes out an insurance policy on his life for $5000 which he assigns to Cook. Later he pays back the $2,000 and then dies. Can Cook recover on the policy? Would it have been different if Carney had taken out a policy payable to Cook?

§ 22. A ship owner takes out a marine insurance policy on his ship. He conceals the fact that the ship is leaky. The ship is destroyed by the surf after running aground in a fog. Can the owner recover on the policy?

§ 28. What is the effect of untrue volunteered information?

§ 34. What is the difference between marine and life insurance in regard to the construction of clauses which are ambigious as to whether they are warranties or representations?

§ § 36-39. Do all warranties necessarily appear in the policy? Must there be at least a reference to them in the policy?

§ 50. What is a qualified warranty?

§ 51. What is a promissory warranty?

§ 55. Name three implied warranties in marine insurance?

§ 56. In marine insurance what is the difference between a voyage policy and a time policy?

§ 61. It is expressly stated that the policy "shall be void" if more than five gallons of gasoline are kept in the house. A ten gallon can full of gasoline is allowed to remain in the house for a few hours and is then taken away. Later a fire is caused by the fumes remaining in the house. Two gallons of gasoline in the same can would have given off the same amount of fumes in the same time. Can there be a recovery on the policy?

§ 69. Is there a change of title where partners owning land form a corporation with only themselves as stockholders and then deed the property to the corporation?

§ 76. What is the difference between "vacant" and "unoccupied" as used in the New York Standard policy?

§ 80. Does a policy become void if the business is legal when the policy is issued but later becomes illegal because of a change in the law?

§ 87. Is an insurance company bound to notify the insured of the premium day in order to give it the right to avoid the policy for non-payment of a premium?

§ 90. What is meant by the waiver of a condition?

§ 102. May mere silence be a waiver of a condition after loss?

§ 100. What is meant by the term "barratry" in marine insurance?

§ 114. What is meant by "friendly" and "hostile" fires?

§ 118. A house is threatened by fire. The goods are removed and are damaged by rain before another shelter can be found for them. The house is not burned. Can a recovery be had on a fire insurance policy?

§ 121. Insured is engaged in robbing a bank. He accidentally locks himself in a safe and is smothered to death. Can there be a recovery on an insurance policy on his life?

§ 129. What is the difference between "accidental death" and "death by accidental means?"

§ 137. What is the doctrine of co-insurance as used in marine insurance?

§ 150. What is meant by subrogation as used in fire insurance?

§ 156. Why has it no application to accident insurance?

APPENDIX D

BANKS, BANKING, AND TRUST COMPANIES.

§ 1. An insurance company invests its profits in loans secured by mortgages. Is it engaged in the banking business?

Can a pawn shop properly be called a bank?

§ § 2, 3. Whence do national banks derive their authority?

§ 5. What is a bank of issue?

§ 5a. What is a savings bank?

§ 6. A statute is passed in Pennsylvania prohibiting all existing unincorporated banking companies from doing banking business. Jones, who has been privately engaged in the business of banking, contends that this statute infringes his common law right to engage in the banking business and is therefore invalid. What decision?

§ § 9-11. Hts a depositor a right to demand from a bank the specific coins that he has deposited?

A depositor deposits $100 with a bank in the ordinary course of business. A few days later and before the bank has made any new investments he goes to the bank and demands that his $100 be invested only in mortgages secured by real estate. Has he a right to demand this?

§ 14. Can there be a general deposit of a chattel?

§ § 15, 16. A circular was issued by the "Depositors' Co-operative Association" inviting deposits on which interest would be paid semi-annually. Plaintiff made a deposit taking a certificate reciting that the money should remain one year, and bear interest at six per cent, but might be sooner withdrawn on notice, and if withdrawn before six months, no interest would be paid. What kind of deposit was this?

§ 17. Jones makes a special deposit of a bag containing coins of United States money. Has he a right to demand the identical coins from the bank?

§ 18. Williams deposits $100 in trust for Johnson an infant. Williams later borrows $50 from the bank giving his note for the same. He does not pay when the note becomes due and the bank claims it has a right to $50 of the $100 deposited by him as trustee. What decision?

§ 22. White deposits $100 with a bank and receives a certificate of deposit. Later he gives a check on the bank for $100 to Green. Green presents the check to the bank and the bank refuses to pay. Is the bank justified in refusing to pay the check?

§ 25. What is a memorandum check?

§ 27, 28. To what control are state banks subjected?

What reason is there for subjecting them to these restrictions?

§ 30. The directors of a bank in good faith, and there being no statutory provision to the contrary, authorize a loan to a minor. They are ignorant of the law that re-payment of a loan to a minor cannot be enforced. Because of this the bank suffers a loss. Have the stockholders any action against the directors?

§ 32. Upon what authority is the national banking act based?

§ 33. What is the essential requirement that must be complied with by national banks?

§ 34. A state law levies a tax on all corporate franchises. Under this law is a national bank required to pay a tax on its franchise?

§ 39. By whom is a clearing house created?

§ 42 What is a clearing house certificate?

TRUST COMPANIES.

§ 44. What is the business of a trust company?

§ 45. Has a trust company power to loan money, taking the borrower's note for its repayment?

§ 46. In what way do trust companies resemble banks?

A trust company borrows money in order to buy stock in an insurance company. Is this act ultra vires?

A trust company lends money on shares of stock in an ice company as collateral. The borrower fails to repay the loan and the stock becomes the property of the bank. On April 10, 1906 when the price of this stock is fluctuating the trust company contracts with Jones to sell him the stock on April 1, 1907 at the market value at that time. Is this contract ultra vires?

APPENDIX E

NEW YORK STANDARD FIRE INSURANCE POLICY (1).

The——Fire Insurance Company in consideration of the stipulations herein named and of——dollars premium does insure—— for the term of——from the——day of——19—, at noon, to the ——day of——, 19—, at noon, against all direct (2) loss or damage by fire (3) to the following described property (4) while located and contained as described herein and not elsewhere (5), to-wit:

This company shall not be liable beyond the actual cash value (6) of the property at the time any loss or damage occurs, and the loss or damage shall be ascertained or estimated according to such actual cash value, with proper deduction for depreciation however caused (7), and shall in no event exceed what it would then cost the insured to repair or replace the same with material of like kind and quality (8), said ascertainment or estimate shall be made by the insured and this company, or, if they differ, then by appraisers, as hereinafter provided; and, the amount of loss or damage having been thus determined, the sum for which this company is liable pursuant to this policy shall be payable sixty days after due notice, ascertainment, estimate, and satisfactory proof of the loss have been received by this company in accordance with the terms of this policy (9). It shall be optional, however, with this company to take all, or any part, of the articles at such ascertained or appraised value, and also to repair, rebuild (10), or replace the property lost or damaged with other of like kind and quality within a reasonable time on giving notice within thirty days after the receipt of the proof herein required of its inten-

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(1) See Sections 130, 131, 132 of the Insurance Law of New York.

(2) See § 112 of this article.

(3) See § 113.

(4) See § 146.

(5) See § 118.

(6) See §§ 138-142.

(7) See § 141.

(8) See § 140.

(9) See §§ 101, 102.

(10) See § 143.

tion so to do, but there can be no abandonment to this company of the property described.

This entire policy shall be void if the insured has concealed, or misrepresented (11), in writing or otherwise, any material fact or circumstance concerning this insurance or the subject thereof or if the interest of the insured in the property be not truly stated herein (12), or in case of any fraud or false swearing by the insured touching any matter relating to this insurance or the subject thereof, whether before or after a loss (13).

This entire policy, unless otherwise provided by agreement indorsed hereon or added hereto (14), shall be void (15) if the insured now has or shall hereafter make or procure any other contract of insurance, whether valid or not, on property covered in whole or in part by this policy (16); or if the subject of insurance be a manufacturing establishment and it be operated in whole or in part at night later than ten o'clock, or if it cease to be operated for more than ten consecutive days (17), or if the hazard be increased by any means within the control or knowledge of the insured (18), or if mechanics be employed in building, altering, or repairing the within described premises for more than fifteen days at any one time (19); or if the interest of the insured be other than unconditional and sole ownership (20); or if the subject of insurance be a building on ground not owned by the insured in fee-simple; or if the subject of insurance be personal property and be or become incumbered by a chattel mortgage; or if, with the knowledge of the insured, foreclosure proceedings be commenced or notice given of sale of any property covered by this policy by virtue of any mortgage or trust deed; or if any change other than by the death of an insured, take place in the interest, title, or possession of the subject of insurance (except change of occupants without increase of hazard) whether by legal process or judgment or by voluntary act of the insured, or otherwise (21); or if this policy be assigned before a loss (22); or if illuminating gas or vapor be generated in the described building (or adjacent

(11) See §§ 23-25.
(12) See § 26.
(13) See § 35.
(14) See §§ 91-93.
(15) See § 61.
(16) See §§ 62-63.
(17) See § 79.
(18) See §§ 64-65.
(19) See § 66.
(20) See § 67.
(21) See §§ 68-70.
(22) See § 17.

thereto) for use therein; or if (any usage or custom of trade or manufacture to the contrary notwithstanding), there be kept, used (23), or allowed on the above described premises, benzine, benzole, dynamite, ether, fireworks, gasoline, greek fire, gunpowder exceeding twenty-five pounds in quantity, naptha, nitro-glycerine or other explosives, phosphorus, or petroleum or any of its products of greater inflammability than kerosene oil of the United States standard, (which last may be used for lights and kept for sale according to law but in quantities not exceeding five barrels, provided it be drawn and lamps filled by daylight or at a distance not less than ten feet from artificial light) (24); or if a building herein described, whether intended for occupancy by owner or tenant, be or become vacant or unoccupied and so remain for ten days (25).

This company shall not be liable for loss caused directly or indirectly by invasion, insurrection, riot, civil war or commotion, or military or usurped power, or by order of any civil authority (26); or by theft (27); or by neglect of the insured to use all reasonable means to save and preserve the property at and after a fire or when the property is endangered by fire in neighboring premises; or (unless fire ensues, and, in that event, for the damage by fire only) by explosion of any kind (28); or lightning (29); but liability for direct damage by lightning may be assumed by specific agreement hereon.

If a building or any part thereof fall, except as the result of fire, all insurance by this policy on such building or its contents shall immediately cease.

This company shall not be liable for loss to accounts, bills, currency, deeds, evidences of debt, money, notes, or securities; nor, unless liability is specifically assumed hereon, for loss to awnings, bullion, casts, curiosities, drawings, dies, implements, jewels, manuscripts, medals, models, patterns, pictures, scientific apparatus, signs, store or office furniture or fixtures, sculpture, tools, or property held on storage or for repairs; nor, beyond the actual value destroyed by fire, for loss occasioned by ordinance or law regulating construction or repair of buildings (30); or by

(23) See § 72.
(24) See §§ 73-75.
(25) See §§ 76-78.
(26) See § 118.
(27) See § 118.
(28) See § 117.
(29) See § 113.
(30) See § 118.

interruption of business, manufacturing processes, or otherwise; nor for any greater proportion of the value of plate glass, frescoes, and decorations than that which this policy shall bear to the whole insurance on the building described.

If an application, survey, plan, or description of property be referred to in this policy it shall be a part of this contract and a warranty by the insured (31).

In any matter relating to this insurance no person, unless duly authorized in writing, shall be deemed the agent of this company.

This policy may by a renewal be continued under the original stipulations, in consideration of premium for the renewed term, provided that any increase of hazard must be made known to this company at the time of renewal or this policy shall be void.

This policy shall be cancelled at any time at the request of the insured; or by the company by giving five days' notice of such cancellation. If this policy shall be cancelled as hereinbefore provided, or become void or cease, the premium having been actually paid, the unearned portion shall be returned on surrender of this policy or last renewal, this company retaining the customary short rate; except that when this policy is cancelled by the company by giving notice it shall retain only the pro rata premium.

If, with the consent of this company, an interest under this policy shall exist in favor of a mortgagee or of any person or corporation having an interest in the subject of insurance other than the interest of the insured as described herein, the conditions hereinbefore contained shall apply in the manner expressed in such provisions and conditions of insurance relating to such interest as shall be written upon, attached, or appended hereto (32).

If property covered by this policy is so endangered by fire as to require removal to a place of safety, and is so removed, that part of this policy in excess of its proportion of any loss and of the value of property remaining in the original location, shall, for the ensuing five days only, cover the property so removed in the new location; if removed to more than one location, such excess of this policy shall cover therein for such

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(31) See §§ 36-39. (32) See § 16.

five days in the proportion that the value in any one such new location bears to the value in all such new locations; but this company shall not, in any case of removal, whether to one or more locations, be liable beyond the proportion that the amount hereby insured shall bear to the total insurance on the whole property at the time of fire, whether the same cover in new location or not.

If fire occurs the insured shall give immediate notice (33) of any loss thereby in writing to this company, protect the property from further damage, forthwith separate the damaged and undamaged personal property, put it in the best possible order, make a complete inventory of the same, stating the quantity and cost of each article and the amount claimed thereon; and, within sixty days after the fire (34), unless such time is extended in writing by this company, shall render a statement to this company, signed and sworn to by said insured, stating the knowledge and belief of the insured as to the time and origin of the fire; the interest of the insured and of all others in the property; the cash value of each item thereof and the amount of loss thereon; all incumbrances thereon; all other insurance, whether valid or not, covering any of said property; and a copy of all the descriptions and schedules in all policies; any changes in the title, use, occupation, location, possession, or exposures of said property since the issuing of this policy; by whom and for what purpose any building herein described and the several parts thereof were occupied at the time of fire; and shall furnish, if required, verified plans and specifications of any building, fixtures, or machinery destroyed or damaged; and shall also, if required, furnish a certificate of the magistrate or notary public (not interested in the claim as a creditor or otherwise, nor related to the insured) living nearest the place of fire, stating that he has examined the circumstances and believes the insured has honestly sustained loss to the amount that such magistrate or notary public shall certify (35).

The insured, as often as required, shall exhibit to any person designated by this company all that remains of any property herein described, and submit to examinations under oath by any person named by this company, and subscribe the same; and, as often as required, shall produce for examination all books of

(33) See § 82.

(34) See § 83.

(35) See § 84.

account, bills, invoices, and other vouchers, or certified copies thereof if originals be lost, at such reasonable place as may be designated by this company or its representative, and shall permit extracts and copies thereof to be made.

In the event of disagreement as to the amount of loss the same shall, as above provided, be ascertained by two competent and disinterested appraisers, the insured and this company each selecting one, and the two so chosen shall first select a competent and disinterested umpire; the appraisers together shall estimate and appraise the loss, stating separately sound value and damage, and, failing to agree, shall submit their differences to the umpire; and the award in writing of any two shall determine the amount of such loss; the parties hereto shall pay the appraiser respectively selected by them and shall bear equally the expenses of the appraisal and umpire (36).

This company shall not be held to have waived any provision or condition of this policy or any forfeiture thereof by any requirement, act, or proceeding on its part relating to the appraisal or to any examination herein provided for (37); and the loss shall not become payable until sixty days after the notice, ascertainment, estimate and satisfactory proof of the loss herein required have been received by this company (38) including an award by appraisers when appraisal has been required.

This company shall not be liable under this policy for a greater proportion of any loss on the described property, or for loss by and expense of removal from premises endangered by fire, than the amount hereby insured shall bear to the whole insurance (39) whether valid or not, or by solvent or insolvent insurers, covering such property, and the extent of the application of the insurance under this policy or of the contribution to be made by this company in case of loss, may be provided for by agreement or condition written hereon or attached or appended hereto. Liability for reinsurance shall be as specifically agreed hereon.

If this company shall claim that the fire was caused by the act or neglect of any person or corporation, private or municipal, this company shall, on payment of the loss, be subrogated to the extent of such payment to all right of recovery by the insured, for the loss resulting therefrom, and such right shall be

(36) See § 143.

(37) See §§ 101-102.

(38) See § 81.

(39) See § 149.

assigned to this company by the insured on receiving such payment (40).

No suit or action on this policy, for the recovery of any claim, shall be sustainable in any court of law or equity until after full compliance by the insured with all the foregoing requirements, nor unless commenced within twelve months next after the fire (41).

Wherever in this policy the word "insured" occurs, it shall be held to include the legal representative of the insured, and wherever the word "loss" occurs, it shall be deemed the equivalent of "loss or damage."

If this policy be made by a mutual or other company having special regulations lawfully applicable to its organization, membership, policies or contracts of insurance, such regulations shall apply to and form a part of this policy as the same may be written or printed upon, attached, or appended hereto.

This policy is made and accepted subject to the foregoing stipulations and conditions, together with such other provisions, agreements, or conditions as may be indorsed hereon or added hereto, and no officer, agent, or other representative of this company shall have power to waive any provision or condition of this policy except such as by the terms of this policy may be subject of agreement indorsed hereon or added hereto, and as to such provisions and conditions no officer, agent, or representative shall have such power or be deemed or held to have waived such provisions or conditions unless such waiver, if any, shall be written upon or attached hereto, nor shall any privilege or permission affecting the insurance under this policy exist or be claimed by the insured unless so written or attached (42).

In witness whereof, this company has executed and attested these presents.

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(40) See §§ 150-151.

(41) See § 81.

(42) See §§ 91-93.